The Quaker Oats Company
Annual Report 1973

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QUAKER

A few of Quaker's people are shown on the covers of this Annual Report—men and women who represent their fellow employees worldwide. You see them with the Quaker products they know best, the brand names they work with every day. We can't introduce you to all of Quaker's people, but we would like you to meet these 25. Some are your neighbors; many make products you buy and use every day; all are important to you as share-holders, employees and others with an interest in the Company. Please see the inside back cover to meet these 25 representatives of Quaker's people.

The Asset That Doesn't Show on the Balance Sheet

The single dimension that cuts across all others in judging the future of Quaker is our people—more than 23,000 men and women around the world.

It's true, of course, that the Company's strong, established brand names, financial resources, manufacturing and distribution capabilities, and research centers are all essential to success. But all of these are only tools until the talent and ability of Quaker's people put them to work.

The people of Quaker dedicate their working lives to the progress of our company—for the benefit of share-holders and consumers, as well as for themselves. So that we may continue to deserve people of integrity, ability and ambition, we strive to maintain an environment for personal development and advancement that provides stimulation, satisfaction and reward.

The quality of excellence of our people would tend to indicate that we have done this successfully. To be certain that this situation remains and is strengthened where possible, we shall continue our emphasis on good compensation and incentive profit-sharing plans, on safe and pleasant work environments, on equal employment opportunities, on assistance to employees in achieving educational objectives, and on benefits that assure a good income for retirement and security in the event of injury, illness or death.

Superior performance is a constant reminder that the qualities of people who contribute most to success in our businesses extend to personal concern about the issues of our times and the needs of others. So it is that Quaker's people are encouraged to work within their communities and occupational fields, to participate in all levels of government, be active in school and church affairs, and to join in many company programs aimed at improving the quality of life. Just a few examples from thousands around the world:

☐ Bruce Donelson, a production manager at the Omaha chemicals plant, who with his wife edits publications for the Garnett-Green Perceptual Motor Training Center—which aids children who have minimal cerebral dysfunction that inhibits educational, social and physical development.

☐ Jose De Leon, an audio-visual operator in Chicago, who is investing substantial amounts of his own time to upgrade his employment skills, with the aid of the Company's tuition-reimbursement program. Jose also devotes many hours a week to working with young children and their families in the Company's tutoring program.

☐ Lura Kilmer, an assembly supervisor at the Fisher-Price plant in East Aurora, who—as service unit director of the Buffalo and Erie County Girl Scouts—puts in almost another whole 40 hours a week supervising the troop leaders for 579 Scouts in five communities in Western New York State.

☐ James Wells, a bulk cereal utility helper at the Cedar Rapids, Iowa, plant, who was recently returned by the voters for his third term in the Iowa House of Representatives.

☐ Ralph Woodhull, now production manager of La Azteca in Mexico City, who—on a previous assignment in Cali, Colombia—worked with his wife to build and help sustain a school in the nearby barrio of Bellavista.

☐ Sandra McNeil, a brand manager in the Cereals and Mixes Division at Company headquarters, who shares with many Quakers—and with her husband, who heads one of Chicago's major urban community action groups—a strong commitment to equal rights and opportunities for all people, and spends her energies accordingly.

☐ Eric Ross, a weigher-mechanic with Quaker Oats Limited at Southall, just outside London in the United Kingdom, who as a member of St. John's Ambulance Brigade gives freely of his time to conduct first aid classes, assist with patient care in hospitals and help attend the injured in accident and other emergency situations.

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The Quaker Oats Company

Annual Meeting Highlights
First Interim Report

Three Months Ending September 30, 1973

QUAKER

First Interim Report
The Quaker Oats Company and Subsidiaries
Statement of Consolidated Income (Unaudited)

Three Months Ended September 30	1973	1972
Sales	$289,910,000	$243,684,000
Income before income taxes	11,223,000	23,426,000
Provision for income taxes	5,271,000	11,860,000
Net income	$ 5,952,000	$ 11,566,000
Net income per common share	$.28	$.58
Average number of common shares outstanding	20,635,749	19,870,183

Note

Interim results are not necessarily indicative of performance for the full year, and are subject to adjustment during the remainder of the fiscal year.

Cover:

Shareholder Kent A. Swanson, age 13, at the reception following the Annual Meeting. Kent, who asked about the energy crisis and its effect on Company business during the discussion period, is the son of Donald E. Swanson, Senior Buyer of Packaging Materials in the Pet Foods Division in Chicago.

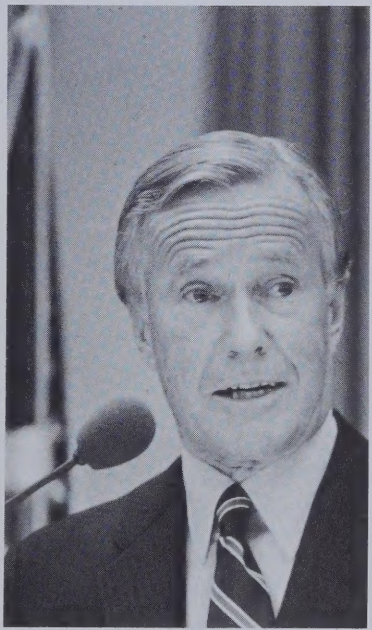
Sales and Earnings

On November 8, we reported that, although sales for the quarter ended September 30 had increased 19 percent over the year-ago period, per-share earnings declined 52 percent. These results were anticipated in a letter mailed to all shareholders on October 18.

Net sales were $289,910,000, compared with $243,684,000 for the first fiscal quarter a year ago. Strong gains were achieved in the U.S. and international grocery products groups and in the Fisher-Price Toys and Chemicals divisions.

Net income was $5,952,000 or 28 cents a share, compared with $11,566,000 or 58 cents a share in the first quarter of the prior year. This earnings decline was principally due to the fact that price relief from exceptionally high grain and other raw agricultural product costs was not achieved until September. Comparative earnings were also adversely affected by disappointing sales and earnings in the Marx and Needlecraft divisions, higher interest expense and cost increases throughout the business.

With continuing strong sales momentum and price increases implemented during and after September, per-share earnings in the remaining nine months of the 1974 fiscal year are expected to be well over 10 percent ahead of the same period a year ago. Thus, we believe our earnings growth momentum has now been resumed.



Robert D. Stuart, Jr.
President and Chief Executive Officer

Annual Meeting Highlights

The Annual Meeting of Shareholders was convened at 9 a.m. on Wednesday, November 14, 1973, at The Northern Trust Company in Chicago. Robert D. Stuart, Jr., President and Chief Executive Officer, presided. About 350 shareholders were present.

Board of Directors

All 17 incumbent Directors were re-elected to serve until next year's Annual Meeting. Their names and principal affiliations are listed on the inside back cover of this report.

Proposals

Voting was completed on four proposals, each of which was described in detail in the Proxy Statement mailed to all shareholders early in October.

☐ A new By-Law was adopted to permit the Board to elect as many as two new Directors in any period between annual meetings to fill directorships created as a result of increasing the size of the Board.

☐ The appointment by the Board of Arthur Andersen & Co., Chicago, as independent auditors for the 1974 fiscal year was approved.

☐ Two proposals made by Mr. Lewis Gilbert, a shareholder, were rejected. The first sought to restore limited pre-emptive rights to shareholders, while the second would have applied certain restrictions to any future stock option plans. These proposals were also rejected by Quaker shareholders at the 1972 annual meeting.

While reporting to you today on the results of a highly successful fiscal year, which ended June 30, it is impossible to begin without expressing disappointment with the first-quarter results of the current year. In the first three months of fiscal 1974, despite very strong sales that were 19 percent ahead of last year, our per-share earnings declined 52 percent.

The principal reason for the earnings decline was our inability, under price controls, to raise human food prices to recover skyrocketing commodity costs. As you know, I have written letters to you twice since July about these problems. When I wrote in July, corn was almost double and soybeans were almost triple their costs of a year earlier. In the Annual Report message, I said that it would be very difficult to achieve good first-quarter results without first getting price relief. In our first fiscal quarter this year—from July to September—we absorbed approximately $13 million of *cost* increases without offsetting *price* increases. Finally, in September we were permitted to raise our food prices. Cost-justified increases have now been implemented, which will help alleviate the earnings problem in the balance of this fiscal year.

Effects of Controls

We should not pass by the first-quarter profit decline without citing it as a dramatic example of how distorted and unreasonable things can become when there is an artificially imposed system to keep consumer prices low, even though costs are escalating. In this case, the government's goal was to hold down politically sensitive consumer food prices, while allowing uncontrolled farm prices to soar in response to world-wide demand for food and protein. Our first-quarter results dramatize the inequities of such a price-control program.

Comparative earnings in the first quarter were also adversely affected by disappointing sales and earnings in the Marx Toys and Needlecraft divisions, higher interest expenses, and cost increases throughout the company.

Outlook

The serious, government-imposed problems of our first quarter have been alleviated by price increases implemented during and after September, and we expect earnings in the remaining nine months to be well over 10 percent ahead of the same period last year. The degree to which, in these nine months, we can surpass the comparable period last year obviously will determine our comparative record for the full year. We are playing a catch-up game this year.

Shortages

There are many serious problems and uncertainties remaining in the world-wide economy. Currently, both supply and price of agricultural commodities appear to be improving, although no one anticipates a return to the price levels of last year or the 1960's. America has been blessed with fine harvest weather and good crops.

But availability and costs of many raw materials are now *international* problems, complicated by the forces of power politics around the world. Energy, petrochemicals, plastics, paper and transportation are just a few of the serious problems of short supply and high costs that must be factored into the management of our business and many other businesses, as well as in our personal lives.

We are in a shortage-dominated, inflationary environment everywhere. Yet, U.S. and Canadian consumers still buy food at the lowest prices in the world. We are going to have to adjust to scarcity and rising prices; governments must work to bring

their expenditures more in line with their incomes so that they stop fueling the inflationary fires; and the U.S. government must end its economic controls program, which simply won't work under these world-wide conditions. The distortions are too great. Fortunately, both the program administrators and the general public have begun to realize this.

Business, and specifically *our* business, will have to work still harder to find ways to increase productivity, seek new cost-saving opportunities, and otherwise apply our talents to achieving our objectives under much more challenging circumstances. Barring a return to absolutely unreasonable price controls, we are confident of our ability to meet these goals.

Reasons for Confidence

Let me cite *five principal reasons* for our confidence in the future, all of which were also demonstrated in the results reported in the fiscal 1973 Annual Report.

☐ The first is the company's *track record* of the last five years. In the fiscal year that ended last June 30, we were able to produce a good 14.6 percent increase in earnings, despite rather difficult economic conditions and controls that were in effect throughout that year. In the last five years our per-share earnings have increased an average of 13 percent a year, and sales have almost doubled. The management team that produced this record is the same one that is currently running the Company.

☐ A second reason for confidence is the *diversification* that now characterizes our business.

The U.S. and Canadian Grocery Products Group is a very large and, over the long run, dependable producer of good sales and earnings. But, whereas in the 1968 fiscal year this group provided 89 percent of our operating income, with only 11 percent coming from all other areas of the business combined, in the 1973 fiscal year we were much less dependent on Grocery Products. Forty-seven percent of our operating income in 1973 came from other areas of the business: the Toys and Recreational Products Group, the Industrial and Institutional Group, and the International Grocery Products Group. And at the same time, the big U.S. and Canadian Grocery Group still showed good growth.

This diversity provides substantial flexibility and strength in managing for the long term. The most obvious example is the tremendous contribution that the Toys and Recreational Products Group provided to corporate progress in the last three years, while the Grocery Products Group was investing for better growth in the future. Of course, other parts of the business that have been doing particularly well—for instance, Chemicals—contribute to this corporate-wide balance.

Diversification broadens the base for future growth. Not infrequently, however, we anticipate periods of time for adjustment and learning to realize the best potential from acquisitions—a situation that prevails now with Marx and Needlecraft. The diversified business as a whole should continue to move ahead well, while we strengthen new areas of promise.

☐ Third, one of our advantages has always been—and still is—our *strong, flexible financial condition.* We plan to maintain our debt ratio conservatively between 25 and 35 percent of total long-term debt and equity. By deliberate policy we maintain a financial position that permits us to take full advantage of investment opportunities that may arise.

High interest rates, of course, affect us as they do others. But we are in an excellent position, and we intend to remain so, to finance our growth. Return on investment is a very important criterion for all of our significant investment decisions. Our growth in earnings in the last five years has been achieved while maintaining our rates of return.

Capital spending last year was $52.6 million. This year we plan to spend as much as 35 percent more than that amount. At the current time, we are making heavy capital investments for future growth in chemicals, toys, pet foods, cereals, frozen foods and art needlework. If you were travelling today in England, Belgium, New York State, Tennessee, West Virginia, Kentucky, Missouri, Florida, or Illinois, you would be able to see significant new facilities under construction to support our planned growth.

☐ A fourth reason for our confidence is that there is a *value concept* underlying our product lines and our overall approach to business that I think is particularly in keeping with current public demand. This is a difficult thing to quantify, but our qualitative goals are very high in all areas. Our strong brand positions and the public's confidence in these brands are the best examples. But I think we have values in our communications, values in our business relationships, values in our people that are also extremely important. In these times of public emphasis on basic values, our company is particularly well positioned.

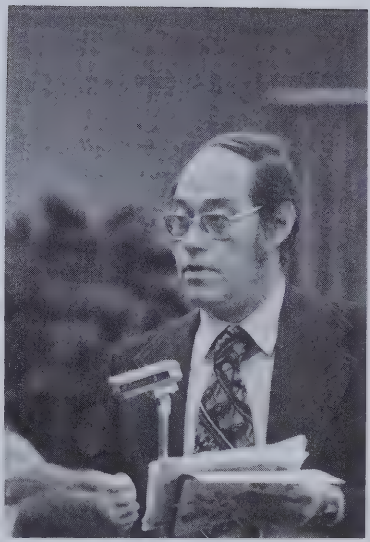
☐ A fifth reason for confidence is the *excellent forward momentum* of the business today.

In the first quarter this year, sales were up 19 percent, continuing the strong trend of last year. I am pleased to report that in October our sales continued to show excellent improvement.

Areas of Opportunity

In the context of the momentum of our business, seven areas of *opportunity* deserve particular mention because of their current or potential growth.

1) A number of our products are benefitting from apparent consumer concern about the relatively higher costs of meat, milk and eggs—and these appear also to be trends from which we will benefit in the future. Our cereals, corn meal and mixes products are showing excellent sales vitality. The line of Cap'n Crunch children's cereals is doing extremely well. Our 100% Natural Cereal is tremendously successful in the 30 percent of the country where it has been available. Right now, we're expanding distribution into New York, Philadelphia, and other parts of the Northeast, coming up to about half the country. A similar product—Quaker Harvest Crunch—is doing very well in Canada.

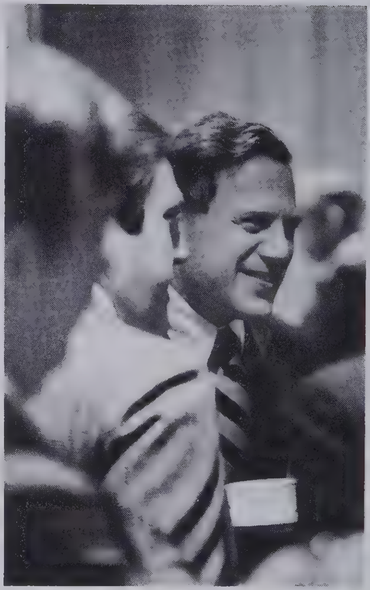


2) A second area of opportunity is that the demand for *specialty convenience foods* continues, and we are in a good position to benefit. Aunt Jemima frozen waffles and french toast and our Celeste frozen pizzas are growing handsomely. One of the new plant investments I just referred to—in Jackson, Tennessee—will increase our capacity to realize the full market potential. Profitability is also improving in our frozen foods business.

3) *Pet foods* continue to be an opportunity area for us—both in the U.S. and around the world. Our technology in making semi-moist pet foods is important to our success in the U.S., and we're making good progress overseas, too. In the U.S., we're already very well established in semi-moist *dog* food with Ken-L Ration Burger and Cheese Flavored Burger, and we'll introduce a very promising semi-moist *cat* food, Puss 'n Boots Moist Meals, here in the United States soon. We

are optimistic about the world-wide growth potential of pet foods.

4) *Toys and other leisure-time products* are a fourth major area of opportunity for us. In the Toys and Recreational Products Group, Fisher-Price sales continue to set new industry records, and although the spectacular growth rate of the past may slow somewhat—this division is now four times as big as it was when the company was acquired four years ago—we believe their sales will continue to grow handsomely. Through Fisher-Price we have been able to capitalize—uniquely—on consumer demand for durable, quality toys that children enjoy. We believe there are certain fundamental concepts that have made Fisher-Price's success possible and that can guide us in new ventures.



Marx performance last year was good. While the first quarter this year was disappointing, we have been able to bring some new strengths to Marx. We believe there is a solid core of basic business and good opportunity for long-term growth.

The Needlecraft Division represents our first venture in a new area—one that has appealing growth characteristics. We've been hit by a profit-margin squeeze, which we expect to resolve. Perhaps the most significant thing about Needlecraft, though, is that it will help us become familiar with what looks like a good growth opportunity in arts, crafts and other leisure-time activities. We will experiment considerably, learn

much more than we know today, and hopefully see ways to turn this into another successful area of diversification.

In toys and recreational products our challenge will be to attain proper margins in combination with sales growth.

5) Our *specialty chemicals* are a very significant area of opportunity. Sales have almost doubled in the last five years, and the growth rate is accelerating. The shortage of petrochemicals may work to our advantage in some ways. That's because our chemicals are based on the cellulosic by-products of farms rather than on petroleum or other scarce resources. And since one of America's great opportunities is to produce more food products for the world, we anticipate an increasing abundance of raw materials for our furfural chemicals.

For example, our furfuryl alcohol is in increasing demand as a binder for cores and molds used in the foundry industry. The major competitive product—phenol—is derived from petroleum and is in short supply. As a result, our sales have received an added impetus, which—along with our attractive performance value for the foundry industry—enhances our long-term position.

6) A sixth area of opportunity where we have a foothold is the growing business of serving people who are eating out more and more. Though our *restaurant service* business is small, we continue to be pleased with the acceptance and success of our Magic Pan crépe restaurants. The specialty concept with the unique decor and menu is proving very appealing to a middle and upper income audience. It is definitely a growth area, if you have the right appeal. We believe we do. We already have 13 Magic Pan Restaurants in 11 cities in the United States, and four more locations will be opened in the next few months.

7) The seventh growth opportunity —*international*—is very encouraging, particularly in chemicals, toys and pet foods; and we're encouraged by the early progress of our new Coquiero canned sardine acquisition in Brazil. Total international business amounted to 22 percent of our sales in fiscal 1973. Not only are our businesses growing overseas, but we are developing an encouraging cadre of international management talent.

Tomorrow, here in Chicago, we'll convene a meeting of the key managers from all major parts of the business. We do this once a year. We start early in the morning and go solidly throughout the day and evening, reviewing our successes and failures, our plans for the current year and the years beyond that. The theme of the meeting this year is "Beyond a Billion," since fiscal 1974 is when we'll surpass that magic number of a billion dollars in sales.

We'll be talking to Quaker managers in much greater detail about the problems, opportunities and challenges we all see for the future. We'll also be talking about our responsibility as a company, since we intend to achieve our second billion dollars in sales, and good increases in income, in a way that is respected and in a style that you will approve of.

How often does the Board of Directors meet, and what is the compensation of its members?

The Board holds regular meetings six times a year—every other month. The annual retainer for "outside" (non-employee) Directors is $5,000.

There are also four Board Committees. The Executive Committee meets twice a month, with extra meetings called when required by the needs of the business. The Audit Committee and the Compensation and Stock Option Committee each met three times during fiscal 1973, and the Public Responsibility Committee met four times.

How much was spent on advertising in fiscal 1973?

Worldwide, the amount was $38.7 million, up about ten percent from the prior year.

What is the book value of the common stock?

At June 30, 1973, it was $14.81, compared with $12.68 the year earlier.

With the strong increases in toy sales in fiscal 1973, have accounts receivable become a problem?

No. Accounts receivable are monitored very carefully at Fisher-Price and Marx and throughout all the other divisions of the Company. In fiscal 1973, receivables company-wide increased 22 percent—against a 25 percent increase in consolidated sales. Based on year-end balances, receivables as a percent of sales actually declined slightly.

What is the policy on dividend payments?

The September dividend increase marked the seventh consecutive year in which Quaker has raised the common stock dividend. Over the past five years, dividends have increased 31 percent. Based on fiscal 1973 earnings per share, the current payout rate is 37 percent. Dividend increases have deliberately been less than per-share earnings increases. That's because retained earnings are invested internally in existing businesses and externally in acquisitions, thus contributing to the growth of the company and, over the longer term, enhancing the value of each shareowner's holdings.

Does the purchase of Company common stock in the Automatic Dividend Reinvestment Program result in the payment of lower brokerage fees?

Yes. Convenience and lower investment costs are principal benefits to Quaker shareholders participating in the program. At present, about 9 percent of Quaker shareholders participate in Automatic Dividend Reinvestment. Close to 12,000 shares have been acquired under the plan.

Does Quaker plan to buy back any of its common stock?

No. Given planned investments in new products and facilities, the continuing investigation of potential acquisitions, and the overall financial structure of the Company, it is presently felt that purchases of Quaker shares would result in a subsequent need to raise funds in the capital markets at an unnecessary expense to the shareholders.

What are the purposes and assets of The Quaker Oats Foundation?

The Foundation's activities are one avenue toward the achievement of a basic Quaker principle—applying corporate resources wherever practical to the solution of public problems in which the interests of shareholders, employees, customers and the general public are fundamentally inseparable.

It is currently funded at about $600,000, which approximates a one-year reserve. Contributions during the 1973 fiscal year were allocated approximately as follows:

Education	*47%*
Community Funds and Red Cross	*22%*
Health Care	*10%*
Youth Programs	*9%*
Urban Affairs	*7%*
Arts & Culture, Civic Affairs, Environmental, and other	*5%*

Did Quaker receive a questionnaire about corporate political contributions from the Senate Watergate Committee and, if so, what was the response?

The Company did not receive any questionnaires. No corporate funds were contributed for any political purpose. The Company is and always has been well aware that such contributions are unethical as well as illegal. Similarly, no officer or employee was reimbursed for personal political contributions.

Is eating Quaker 100% Natural Cereal a problem for people on low-cholesterol or low-fat diets?

First, it's necessary to distinguish between "low-cholesterol" and "low-fat." Cholesterol comes from *animal* fat sources, not *vegetable* fat. The animal fat content of our 100% Natural Cereal is negligible, and thus cholesterol is not a problem.

Some people are on "low-fat" diets even though they do not have a cholesterol problem. The amount of fat in a serving of 100% Natural Cereal is small, but the bulk of it is *saturated*. Thus, people who want to reduce their saturated fat intake might want to select other cereals. A good choice is Quaker oatmeal, which is cholesterol-free and contains primarily unsaturated fat. Most of the other cereals made by the Company contain very low contents of cholesterol and saturated fats.

If you would like a recipe to make a cereal somewhat similar to 100% Natural Cereal but without saturated fat, please write to the Consumer Services Department, The Quaker Oats Company, Merchandise Mart Plaza, Chicago, Illinois, 60654.

What is the outlook for new products in Quaker pet foods?

The Company has had good success with the so-called semi-moist or burger-type dog foods—Ken-L Ration Burger and Cheese-Flavored Burger. Puss 'n Boots Moist Meals, a semi-moist cat food, will be introduced soon. Other product varieties of both dog and cat food are being sold in Canada, Europe and Australia. Worldwide, pet foods provide Quaker with some excellent opportunities, which are being vigorously pursued.

Are sales of furfural and other products of the Chemicals Division continuing their upward trend?

Yes, they are. Indeed, the biggest problem is bringing production facilities on stream fast enough to meet expanding demand in the United States and Europe. Because the Company's chemicals are based on agricultural by-products rather than on scarce petroleum, there may be some significant opportunities. A $7 million plant expansion was recently approved, and other new investments are planned.

What effect will the energy crisis have on Quaker, apart from any benefits that may accrue to the Chemicals Division?

The subject is obviously of great concern to everyone these days, complicated as it is by strong international political implications. One immediate problem is the availability and cost of plastics used by both Fisher-Price and Marx to make toys. Contingency plans are being developed to adjust to shortages where it appears this may be necessary. Of course, if other industries decrease their needs, there may be adequate plastics for toys. Beyond that the Company intends to cooperate fully with the emerging national energy policies, since the situation obviously calls for such cooperation from all corporate citizens as well as individuals.

In addition, shareholders discussed potential pet food products, business potential in the Far East, the lack of profit from the Willy Wonka movie, the handling of fractional shares in past stock splits, relationships with U.S. transfer agents for the common stock, the value of outstanding stock options, and the time of the annual meeting.

The meeting was adjourned at 10:30 a.m.

Directors

Silas S. Cathcart
Chairman and Chief Executive Officer, Illinois Tool Works, Inc.
Chicago, Illinois

John D'Arcy, Jr.
Senior Vice President
Operations and Administration

W. Fenton Guinee
Senior Vice President
Finance and Planning

Richard D. Harrison
President and Chief Executive Officer
The Fleming Companies, Inc.
Oklahoma City, Oklahoma

Augustin S. Hart, Jr.
Group Vice President
International Grocery Products

Dr. Lawrence A. Kimpton
Formerly Chancellor
University of Chicago

Kenneth Mason
Group Vice President
Grocery Products

Archibald McClure
Group Vice President
Industrial and Institutional Products

Donald E. Meads
Executive Vice President and Director
INA Corporation
Philadelphia, Pennsylvania

Mrs. G. G. Michelson
Senior Vice President
Macy's New York
New York City

Merrill E. Olsen
Formerly Vice President and General Counsel

Dr. Walter J. Salmon
S. S. Kresge Professor of Marketing
Harvard Business School
Boston, Massachusetts

Frank C. Schell, Jr.
Group Vice President
Toys and Recreational Products

Gilbert H. Scribner, Jr.
President, Scribner & Co.
Chicago, Illinois

Robert D. Stuart, Jr.
President and Chief Executive Officer

Robert N. Thurston
Senior Vice President
Corporate Affairs

Arthur M. Wood
Chairman and Chief Executive Officer, Sears, Roebuck and Co.
Chicago, Illinois

The Quaker Oats Company
Merchandise Mart Plaza, Chicago, Illinois 60654

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Presentation to Financial Analysts by The Quaker Oats Company

New York City
April 18, 1973

On April 18, 1973, Quaker made a presentation to a group of financial analysts who follow consumer-goods industries. The meeting was held at the Company's Magic Pan restaurant in New York City.

Speakers included:

Robert D. Stuart, Jr.
President and Chief Executive Officer

Kenneth Mason
Group Vice President
U.S. and Canadian Grocery Products

Frank C. Schell, Jr.
Group Vice President
Toys and Recreational Products

Mr. Stuart:

Five years ago we made a presentation to security analysts in Los Angeles. I single out that presentation because it offers a five-year period of comparison, and because most of the fundamental business concepts we emphasized then are still very basic to us today. At that time we said that there were five important points we wanted to emphasize:

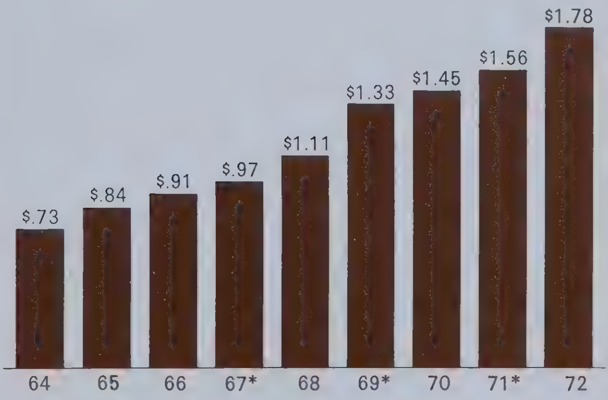
1. Earnings Growth
2. Planned Progress
3. Brand Leadership
4. Return on Investment
5. Young Management

Since then, a great many things have developed according to plan, but—let's face it—no matter how precise the planning process (and ours has improved considerably), there are always unexpected opportunities and disappointments. We've had our share of both, but the important point is that our management group has demonstrated the ability to deliver the promise of the plans.

Five Years of Progress

Let's look at some significant points that demonstrate our development over the last five years.

Earnings Per Share



Year Ended June 30
Adjusted for Splits.
*Excluding Extraordinary Item.

1. We have consistently met the earnings objective we cited: improvement in per-share results, before extraordinary items, on an average of at least 10 percent a year over any five-year period. We are confident that the current 1973 fiscal year, ending June 30, will mark five years of successful pursuit of this objective. And—we expect to continue.

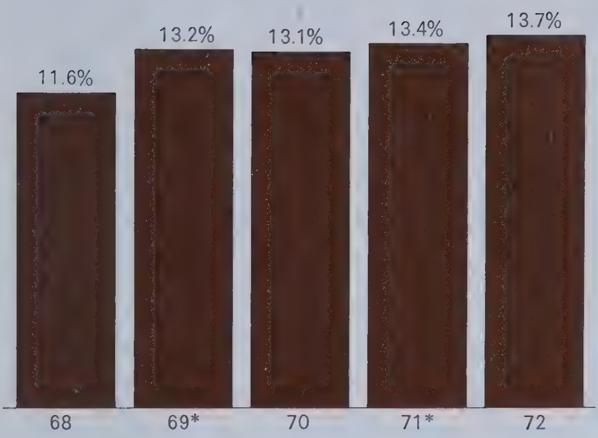
5-Year Earnings Growth
(Moving Average)

5-yr. Periods Ending June 30	5-yr. Average Per-Share Earnings Improvement*
1969	12.8%
1970	11.6%
1971	11.5%
1972	13.0%

*Before extraordinary items in 1967, 1969 and 1971.

2. The moving five-year rate of annual improvement has been quite stable and closely in accord with our objective of at least 10 percent. We've maintained this stability during a period when our resources have been redeployed very significantly in many areas.

3. Brand leadership remains the key factor in our business. A substantial part of the major progress we have made in the last five years has been based on our strong franchises and brand leadership in grocery products. In toys, there are a number of new products developed under the Fisher-Price brand since the acquisition. We expect brand leadership to continue as a major cornerstone of future growth here also.



Year Ended June 30
*Excluding Extraordinary Item

4. Return on investment continues to be a very significant standard for us. We spend a lot of effort analyzing new investment projects to be sure they have sufficient potential. The divestiture of our former agricultural products businesses and the investment in the toy businesses were both based essentially on rate-of-return concepts. During this period of major change, increased capital spending and increased equity, we have been able to maintain return on shareholders' equity at satisfactory levels.

5. Obviously, some of us are a little older than we were five years ago—which is perhaps why we've made The Quaker Man younger, or at least more modern.

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Seriously, our top management team—with an average age of 50 on our Executive Committee—is basically the same one that has directed our efforts over the last five years. Throughout the organization, the emphasis is on giving major responsibility to young people with ability.

We believe we have lived by these five principles of growth announced in Los Angeles in 1968. Now, let's look at the score card.

5-Year Sales by Operating Group
millions of dollars

	Year Ended June 30				
	68	69	70	71	72
Grocery Products	$315	$350	$391	$429	$469
International Grocery Products	63	65	71	87	107
Industrial & Institutional	89	94	101	104	102
Toys and Recreational Products	—	—	35	59	93
Total	$467	$509	$598	$679	$771

This chart shows our past five years' sales, broken down into our four major business groups. As you can see, consolidated sales have grown at a rate of about 14 percent per year, reflecting consistent stable growth in Grocery Products at a rate of about 10 percent, and—beginning in 1970—the outstanding performance in Toys and Recreational Products, which during this period was only Fisher-Price. (Marx Toys was purchased June 30, 1972.) I think it's important to note that, for the most part, we have not grown just by acquiring existing sales volume. Most of the sales increases have been produced by our existing business and by sales growth of acquired companies *after* the acquisition.

Specifically, only about 20 percent of the sales growth in the last five years is accounted for by sales of acquired companies at the time of acquisition. The remainder—or about 80 percent—was generated under Quaker management.

During this same period, overall operating income has increased at about 14 percent annually. We reorganized our operations a couple of years ago, so we can't give you five-year operating earnings by each Group for the years prior to that. But from the data that *are* available, it's obvious that Grocery Products was responsible for the good progress of the first three years, and—as we've reported—the most significant growth in the last two came from Fisher-Price. Again it's worth noting that, while Fisher-Price brought some good established earnings to Quaker, a much larger contribution by this division has been added since the acquisition.

Most of you are familiar with our figures and are aware of the significant trends. Two of the most important are:

a. the relatively level Grocery Products profit record in F-71 and F-72, and
b. the very dramatic increase in Toys and Recreational Products.

We, of course, do not know yet what the fiscal 1973 full-year figures will show. We do expect a fine year, though, with results well in line with our 10 percent objective. Most of the gain will again come from Toys and Recreational Products, although U.S. and Canadian Grocery Products should show a moderate improvement over last year. These trends are at the heart of most of the questions that analysts ask us these days, and we address ourselves to them in the remarks that follow.

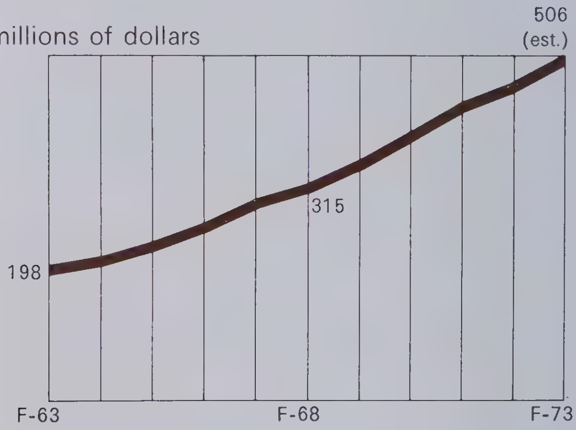
Ken Mason, who directs our U.S. and Canadian Grocery Products business, will tell you about the progress he expects in his area. Then, Frank Schell, our Toys and Recreational Products Group Vice President, will do the same for his part of the business.

Grocery Products Group

Mr. Mason:

I'm delighted to have the opportunity to talk to you about our grocery products business.

Grocery Products Group
Net Sales



Average Annual Growth
Last 10 Years 9.9%
Last 5 Years 10.0%
Fiscal years ended June 30

As you can see from the Net Sales chart, it's a growing business—with sales up about 10 percent per year for ten full years.

Food Brands

While several factors have accounted for this healthy upward trend, the most important, by far, is the remarkable vitality of our Company's brands.

The most famous of these, Quaker Oats, is not only one of the world's best known food products, but—and this is something most people are not aware of—it continues to be the number-one brand of breakfast cereal, hot or cold, in the United States today.

More pounds—which is the same as servings—of Quaker Oats are sold in grocery stores today than any other brand of breakfast cereal, hot or cold, in the United States. And this is after 100 years in the marketplace! The durability of this brand makes you realize what a truly remarkable consumer value oatmeal is.

The Quaker name has obviously been extremely helpful in building our ready-to-eat cereal business, too. Our market share has more than doubled in the last ten years to almost 10 percent currently. And since the ready-to-eat market itself is now growing again very nicely, we're doubly encouraged about our opportunities in this field.

Another of the world's oldest and most famous brands is Aunt Jemima, which continues to hold the number-one position in pancake mixes, and is now building a very nice franchise in frozen foods, too.

Pet Foods

In pet foods we've experienced some loss of market share in recent years, although our sales have doubled in the last five years.

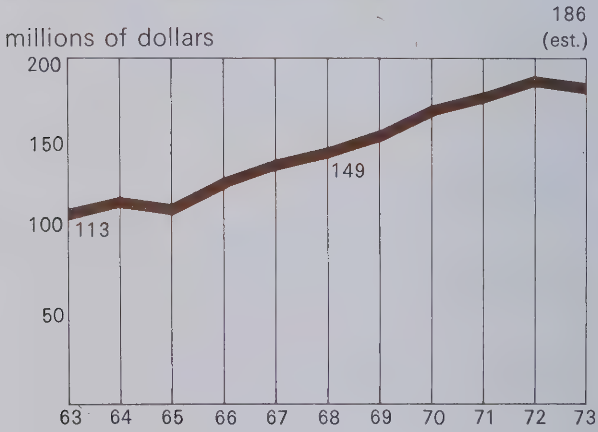
Despite the inroads into our market share, however, the Puss 'n Boots brand still sells more pounds of canned cat food than any other brand, even after 40 years in the market. And Ken-L Ration, building from its very strong base in canned dog foods, has been spectacularly successful in the new semi-moist segment of the market. This is the fastest growing segment in dog food, and we're very close to over-taking the leading brand, if we haven't actually done so already. An advantage of semi-moist pet foods is that they are less influenced by meat price and availability problems than other pet food products. And so we're continuing to concentrate a very large percentage of our R&D effort on this area—not only in the United States and Canada, but world-wide.

Mature Markets

But while famous brands like Quaker, Aunt Jemima, Ken-L Ration and Puss 'n Boots have great appeal from the consumer's point of view, to the security analyst they sometimes are seen as a question mark: Are these brands so old that they have topped out? Do they now offer only limited opportunity for future growth?

The questions are good ones, because it is quite true that many of the products that have played an important role in Quaker's growth do derive their sales from mature market segments.

Grocery Products Group
Net Sales—Mature Markets



Average Annual Growth
Last 10 Years 5.2%
Last 5 Years 4.6%
Fiscal years ended June 30

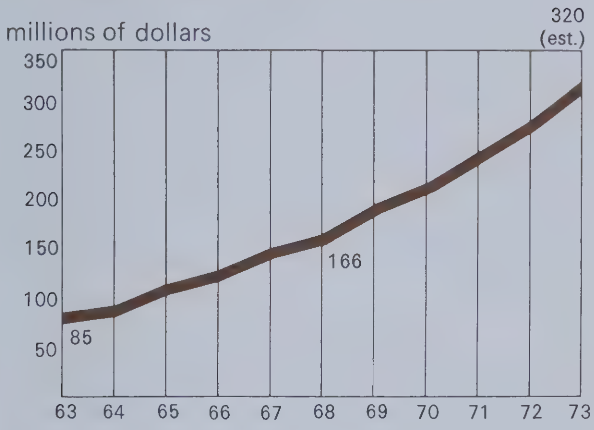
includes:
Hot Cereals
Mixes & Syrup
Corn Products
Other

Quaker product categories that are clearly mature include hot cereals, pancake and other mixes, syrup and corn goods. The Mature Markets chart shows the sales trend of these products, combined with miscellaneous items such as Wolf Brand Chili and some other hard-to-classify product areas.

As you would expect, Quaker sales growth in this group has been modest, averaging around 5 percent per year over the last ten years.

Opportunity Markets

Grocery Products Group
Net Sales—Opportunity Markets



Average Annual Growth
Last 10 Years 14.2%
Last 5 Years 14.1%
Fiscal years ended June 30

includes:
Pet Foods
Frozen Foods
Ready-To-Eat Cereals

A much larger percentage of our business is now being derived from our opportunity markets—three areas where we have been concentrating our new-product development efforts, including pet foods, ready-to-eat cereals, and frozen prepared foods. Our sales in these categories have grown at an average annual rate of better than 14 percent, not only over the last ten years, but also over the last five.

Grocery Products Group
Mature Markets vs. Opportunity Markets
Share of Sales

	F-63	F-68	F-73
Mature Markets	56.9%	47.3%	36.7%
Opportunity Markets	43.1%	52.7%	63.3%

These three opportunity markets now account for 63 percent of our total sales, up from 43 percent ten years ago and 53 percent five years ago. This critical fact about our business is the basis for much of the confidence we feel about our opportunity for good growth in sales and profits in the years immediately ahead.

Operating Income Trends

Speaking of profits, many of you may wonder why, after so many years of excellent growth, our operating income has leveled out to the extent it has in the last couple of years? And, is this leveling trend temporary or likely to persist?

A leveling trend of operating income in the Grocery Products Group should not persist. The principal factors that caused income to level for a couple of years are no longer present in the business. In fact, the current fiscal year should begin to show the uptrend. Here's why:

During fiscal years 1971, 1972 and 1973, we launched seven *major* new products into the marketplace. This New Product Introduction chart shows what they were and indicates their current status. The results appear to have been five hits and two misses.

Grocery Products Group
New Product Introductions
Fiscal 71-73

Product	Current Status
King Vitaman Cereal	$10 million Annual Sales
Quaker 100% Natural Cereal	High Market Share
Aunt Jemima French Toast	$12 million Annual Sales
Celeste Pizza	$10 million Annual Sales
Ken-L Ration Cheese Flavored Burger	$20 million Annual Sales
Willy Wonka Candy	Divested January, 1973
Willie Wonka Movie	Written Off, Fiscal '72

The two projects that failed—candy and the movie—are now behind us. The drain on pre-tax income from the candy project in fiscal 1972 and this year was about $4 million each year.

The five new products that appear to be satisfactory market entries on the basis of our experience to date are: King Vitaman cereal, which fell short of our objectives for it in fiscal 1972, but which has done well since and now looks to be a reasonably reliable income producer; our new Quaker 100% Natural Cereal, which is at this time being offered in only 30 percent of the United States but is selling as much in that limited area as many cereals sell nationally; and Aunt Jemima French Toast, Celeste Pizzas, and Cheese Flavored Ken-L Ration Burger—all of which have achieved sales levels that indicate there is a lasting place for them in the market.

These seven ventures represent a much more substantial and more compressed new-product effort than we have typically scheduled in the Grocery Group. In fact, the marketing investment these seven projects required during the three-year period, 1971-1973, was more than double the new-product marketing investment we incurred during the previous three-year period. It also is significantly heavier than our plans call for during the next three years, principally because there is nothing in our picture at this time that could cause us to incur short-term operating losses of the size we incurred in the candy business.

Does this mean we are cutting back on new products? Definitely not. Our expenditures for research and development for Grocery Products are at an all-time high, and both trends will continue.

Grocery Products Outlook

In summary, the outlook for good improvement in operating income in the years immediately ahead looks sound for clearly identifiable reasons —provided, of course, that factors affecting costs do not get completely out of control. The most serious of these at the moment is the drastic rise in the cost of grain and other key ingredients in our products, complicated by transportation problems. Thanks to the great strength of our brand franchises, we have been able to cushion at least partially the adverse effect of these escalating costs by temporarily cutting back on expenditures for advertising and promotion on established products. We have also been able to raise some prices in pet foods. We believe the worst is behind us insofar as the crisis in the commodity market is concerned. But of course, only time will tell whether we are right or not.

There are other uncertainties, too: critical attacks on advertising and marketing, complex regulations in the area of nutrition and health, and so on. Rather than viewing these solely as problems, however, we believe that the overall thrust of consumerism in the U.S. is an opportunity for our company, not a threat.

In a marketing environment where quality and value are coming back into their own, and in a world where good value in nutrition has become one of the key concerns of our time, Quaker's historic ability to communicate these values is one of its most important assets. And so, I am going to close my remarks by asking you to look at just a few of the television commercials currently on the air for our grocery products. This is how the consumer sees us, and our confidence in the way the consumer sees us is one of the most important reasons we are so optimistic about the future. After six grocery commercials you'll see a few toy commercials, which will serve to introduce my colleague, Frank Schell.

(TV commercials were shown.)

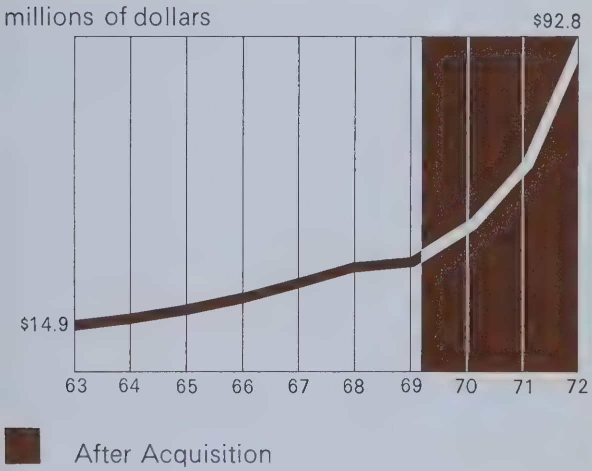
Toys and Recreational Products Group

Mr. Schell:

Quaker entered the toy business in September, 1969, with the acquisition of Fisher-Price Toys.

As you know, our experience with that acquisition has been highly satisfactory both to the parent company and to the division itself, which has enjoyed unprecedented growth. Sales under Quaker ownership in fiscal 1970 were $35 million. At the end of fiscal 1972, they had grown to $93 million.

Toys and Recreational Products Group
Fisher-Price Sales



In July, 1972, we added Louis Marx & Company and Needlecraft Corporation of America to the Group. This fiscal year, Toys and Recreational Products—which did not exist four years ago—should account for close to 25 percent of Quaker's consolidated sales and an even higher percentage of operating income.

We continue to be very enthusiastic about Fisher-Price's future and are most optimistic on the basis of nine months' experience about the potential of the two new acquisitions. In both the toy and art needlework industries, we are operating in a growth environment.

Fisher-Price Toys

New-product development is critically important in the toy industry. Fisher-Price has demonstrated its capability in this area in the past, and this year there's another fine group of new Fisher-Price products.

Most of them were introduced two months ago at the Toy Fair, and the trade reception has been excellent. Although many are in our traditional areas, Fisher-Price is also moving into new categories, including:

1. Infant toys, with the Crib and Playpen line. Market research has told us that mothers *expect* Fisher-Price to be in this area.
2. Action games, including a new bowling game and a basketball game for small children.
3. A new action movie viewer, with children's films supplied through a tie-in with both Walt Disney and Sesame Street. The market already shows a demonstrated interest by youngsters in such products.

One of the great strengths of the Fisher-Price business is that our toys are regarded by the trade as *staples.* They have long life expectancies and are not highly dependent on consumer whims and heavy promotion.

An additional element in the program of planned growth at Fisher-Price is our European opportunity. We have a new subsidiary, Fisher-Price Toys Ltd. in England, that has a contract-manufacturing and selling arrangement with Mettoy Ltd., a leading English toy company known for high-quality products. We control the advertising and merchandising activity. Progress to date has been extremely encouraging, and we believe there are substantial new business opportunities for us in the Common Market.

In addition to providing a number of facilities for production since the acquisition, we are now doubling the size of our Research and Development building—which, as many of you know, includes a nursery school facility that is most helpful in our overall product development program.

Consumer concern about value, durability, safety, and quality should continue to be a strong asset to Fisher-Price. In addition to our fine standing with the consumer, the retail trade has honored the division with awards for Manufacturer of the Year, Best Product Line, and Best Packaging in our industry.

One of the principal considerations in Quaker's acquisition of Fisher-Price was the presence of a professional management team. That team generally has remained intact and continues to turn in an outstanding performance. Because we had this good depth of management, some of our key Fisher-Price executives have now moved into the Marx Division.

Marx Toys

This division produces a broad line of riding toys, games, play sets, trains and other toys. Marx has a very fine reputation in the trade and, as in the case of Fisher-Price, we are also known as a producer of *staples*. Many of the best-selling items in the Marx line have been offered for many years, so that there is a solid base from which to expand. The division has been conservatively managed and has been a profitable business over a long period of years. We believe there is considerable upside potential for Marx, and we intend to move on it aggressively.

Marx also has a fine new-product development and testing capability. The trade reaction to the new Marx toys at the Toy Fair was highly favorable. Some of the new items in the line that show good promise for 1973 and beyond include Chugging Choo Choo, the Longhorn Sidewalk Bike, Pistol Polo, the Magic Shot Gallery, and a children's molded furniture line—the Huski-Bilt Table and Chair Set.

A new logo is being used in Marx packaging and advertising, coupled with the slogan "If we make it, it can take it"—signifying the division's commitment to quality and durability. There will be much greater emphasis on capitalizing on the value of the Marx identity, just as we have capitalized on our great names in grocery products and on Fisher-Price. For the first time,

a portion of Marx advertising will be directed to parents rather than children—both on TV and in print.

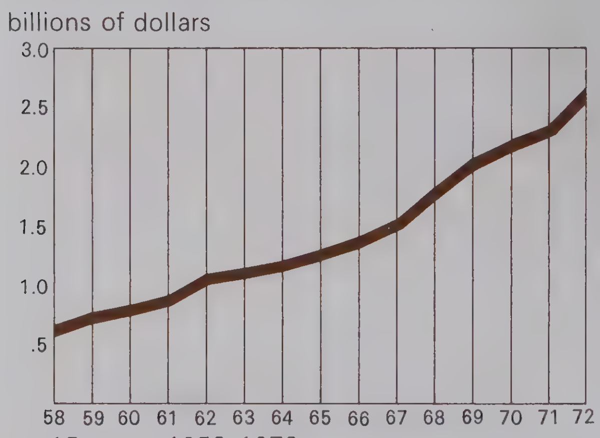
The Toy Industry

With both of our divisions in the toy industry, we believe we have certain distinguishing characteristics that set us apart from many other companies in the field. They include:

1. Greater stability of product line;
2. Heavy emphasis on internal research and development, with demonstrated technological capability:
3. Relatively less dependence on foreign sources;
4. Relatively lower levels of promotion required across the total line;
5. Distinctiveness of individual items in the line;
6. Heavy emphasis on professional management.

As far as the future of the toy industry is concerned, we believe that it can continue to grow as it has in the past. Questions about industry volatility and declining birth rates have been raised. There certainly are companies within the industry whose records are volatile. However, industry figures show that aggregate volume has grown very satisfactorily.

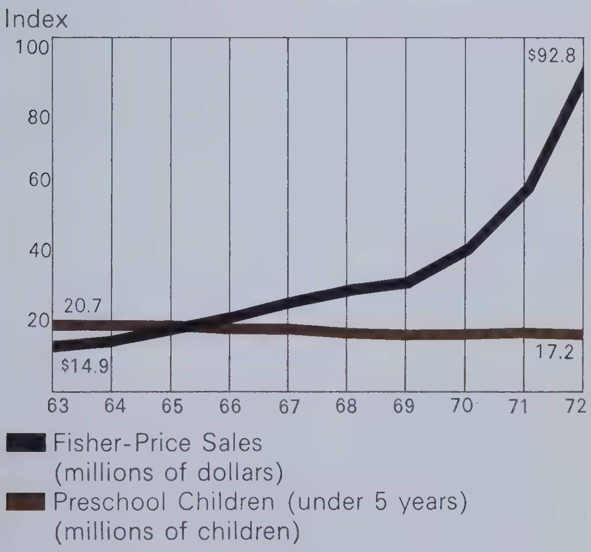
Toy Manufacturers' Sales



15 years, 1958-1972
Source: Toy Manufacturers of America

Many people ask about the impact of birth rates on toy sales. This matter should be considered in light of our experience in the past, when our volume at Fisher-Price increased very significantly despite a *decrease* in the number of pre-school children. Actually, discretionary spending power and the number of first births seem to be more relevant to our growth in volume than do the total numbers of children.

Toys and Recreational Products Group
Fisher-Price Sales vs. Preschool Population



Needlecraft Division

Needlecraft is also operating in an industry growth environment. We entered this field because of this growth opportunity, with the expectation that we could provide additional strength to a successful company with a fine management team. That same management team is running the business today.

The division makes basic hand-knitting and other yarns, both synthetic and wool; creative stitchery kits (needlepoint, crewel, embroidery); and operates a mail-order business in art needlework and related items. Our trade customers are the variety stores and mass merchandisers. We are the only company in the art needlework field serving these distribution channels that is vertically integrated. We see opportunities both to expand our distribution and to provide the mass market with products that are selling well in specialty and department stores—for example, needlepoint products.

There is a great interest today in art needlework, as many of you know from your personal experience at home or from looking at the newsstands with their many magazines concentrating on this field.

Our Needlecraft Division sales this year will have increased about four times since 1968. The handwork yarn market, at manufacturer level, has grown at a rate of better than 30 percent over the period from 1967 to 1971.

57 Handwork Yarns
Manufacturer Sales

	millions of pounds
1967	29.2
1968	36.4
1969	44.8
1970	70.8
1971	82.4

Source: Textile Economics Bureau

The performance of the Needlecraft Division since the acquisition has been good, and we are optimistic about our long-term potential in this leisure-time area.

Group Outlook

Thus, we feel that the Toys and Recreational Products Group has excellent prospects for the future. We intend to (1) sustain the outstanding record of Fisher-Price, but realistically at a growth rate lower than that we've seen in the past; and (2) increase the volume and profits of our two fine new acquisitions. We expect to continue to be a major contributor to corporate improvement goals.

Other Growth Areas

Mr. Stuart:

We are at a point in Grocery Products where we're optimistic about significant profit growth. In Toys and Recreational Products, we are confident that our brand positions and professional management will enable us to continue to perform very well. But there are some smaller businesses in our other groups that also have exciting potential. International Pet Foods is one.

Domestic pet foods continue to be a key growth market in this country, and our market position in Canada is very strong. The pet food business in other economically developed countries is growing even faster than in the U.S. Recognizing this growth potential and our technological advantages, a couple of years ago we embarked on a program to establish ourselves as a major factor in pet foods in Europe and Australia.

In England and on the Continent, we have introduced our semi-moist pet foods. Initial reception has been very good in a total market that promises excellent growth. In Australia, we purchased the "Luv" pet food business about a year ago, thereby attaining a strong number-two position in that country. These ventures, together with related market development work, are costly initially. But, if we are successful, as we expect to be, we will realize an important source of new earning power in the future.

Our Industrial and Institutional Group consists of three separate parts. Most of our institutional business is done through the Burry Division—where, as you know, we've had plenty of problems. In the past couple of years, however, we've done some major surgery and have significantly changed Burry's structure. Today it is a healthy business.

Our specialty chemicals business is another growth area for us. As you know from our past figures, the Chemicals Division has made excellent progress, with sales increases over the past five years running at a rate of better than 15 percent a year.

In the recent past much of this increase has come from Europe, where important technological breakthroughs have created substantial new demand for our furfuryl alcohol products as a binder in the widely used sand-molding foundry process. These unique chemical binders make it possible to produce better castings at much lower cost, principally because of closer-tolerance sand cores and the reclamation of the actual mold sand. These new foundry techniques are of interest in this country, too, with the result that a very substantial new market appears to be opening up for furfural binders. There are important ecological advantages here, too—no toxicity in fumes and no problem of disposal. Our studies suggest that we have an exciting investment opportunity that could result in significant improvement in our chemical earnings over the next five years. Thus, this relatively small business that has performed so nicely over the years may well represent an important source of new earning power for us.

Our Magic Pan Restaurants have a special charm, and we think they may well represent fine potential. We've been expanding cautiously so far, trying out different locations, seating capacities, etc., to determine the optimum approach. With ten units now in operation and two more soon to open, we have learned a lot about this business. We're developing a strategy now that could lead to a major expansion. While we continue to move carefully, we are becoming increasingly optimistic about distinctive concept-restaurants such as Magic Pan, and how such operations can make an important contribution to future earnings growth.

The Years Ahead

To sum up, our corporate plans indicate more than enough new earning power to support our overall earnings growth goal. In addition, we will continue to look very selectively for attractive acquisitions, either to complement present businesses or to add another major business diversification to our overall picture.

Our corporate financial objective in the years ahead continues to be improvement in per-share earnings—an average of at least 10 percent a year over any five-year period. Our strategy to achieve that objective can be summarized in these four points:

1. We will capitalize fully on one of our major strengths: those strong, stable product lines that produce dependable earnings.
2. We will move aggressively to realize all the growth opportunities we see in our current businesses.
3. We will seek growth via acquisitions in other areas that offer consumers distinctive products or services, and to which we can bring additional strength.
4. We will maintain a strong financial structure.

The Quaker Oats Company
Merchandise Mart Plaza
Chicago, Illinois 60654

a program to further expand this business, Fisher-Price is entering the doll business this year with six dolls that are expected to have special appeal.

Marx Toys Division sales for the six months were level, and profits were below last year. Needlecraft Division performance continued to be comparatively weak.

International Grocery Products and the Chemicals Division are doing particularly well. We just recently authorized construction of a new $26 million furfural and furfuryl alcohol chemicals facility—the largest plant investment in company history. Our chemicals are based on agricultural by-products rather than on petroleum derivatives. Demand is currently in excess of supply and is likely to remain so until the new facility comes on stream in early 1976.

Robert D. Stuart Jr.

Robert D. Stuart, Jr.
President

To Our Shareholders:

Sales for the second quarter were $330.5 million, compared with $278 million a year ago—a gain of 19 percent. Net income was $13 million, or 63 cents a share for the three months ended December 31, compared with $13.4 million, or 65 cents a share last year—off 3 percent.

For the first half ended December 31, sales were also up 19 percent, but earnings per share were off 26 percent, primarily reflecting the significant decline in earnings previously reported for the first quarter. Sales were $620.4 million, compared with $521.7 million for the six months a year ago. Earnings were 91 cents a share, compared with $1.23 a share for the first half last year.

At the end of the first quarter, while noting disappointing sales and earnings in the Marx and Needlecraft Divisions and cost pressures across the company, we said that "the earnings decline was due principally to the fact that price relief from exceptionally high grain and other raw agricultural product costs was not achieved until September."

Sales of U.S. grocery products continued very strong in the second quarter, and margins recovered substantially from the depressed levels of the first quarter. Quaker 100% Natural Cereal continues to do extremely well, and capacity has been added to permit full national distribution very soon. Other significant investments are underway for Puss 'n Boots Moist Meals, a semi-moist cat food introduced in three major markets last month, and for our Celeste frozen foods business.

Profitability in the Toys and Recreational Products Group was below expectations for the full six months, reflecting exceptional cost increases without price increases. This will make it unlikely that we can achieve the better-than-10 percent corporate earnings-improvement projection made in October for the remaining nine months of the fiscal year.

Fisher-Price Toys Division sales were again outstanding. Margins were narrowed and profits were somewhat lower than last year, although they are still at very respectable levels. As part of

The Quaker Oats Company and Subsidiaries Statement of Consolidated Income (unaudited)

(In thousands, except per-share)	Three Months Ended December 31		Six Months Ended December 31	
	1973	**1972**	**1973**	**1972**
Sales	**$330,478**	$278,016	**$620,388**	$521,700
Income before income taxes	**26,157**	27,484	**37,380**	50,910
Provision for income taxes	**13,136**	14,076	**18,407**	25,936
Net income	**$ 13,021**	$ 13,408	**$ 18,973**	$ 24,974
Net income per common share	**$ .63**	$ .65	**$ .91**	$ 1.23
Average number of common shares outstanding for the period	**20,676**	20,234	**20,655**	20,086

Note: Interim results are not necessarily indicative of performance for the full year, and are subject to adjustment during the remainder of the fiscal year.

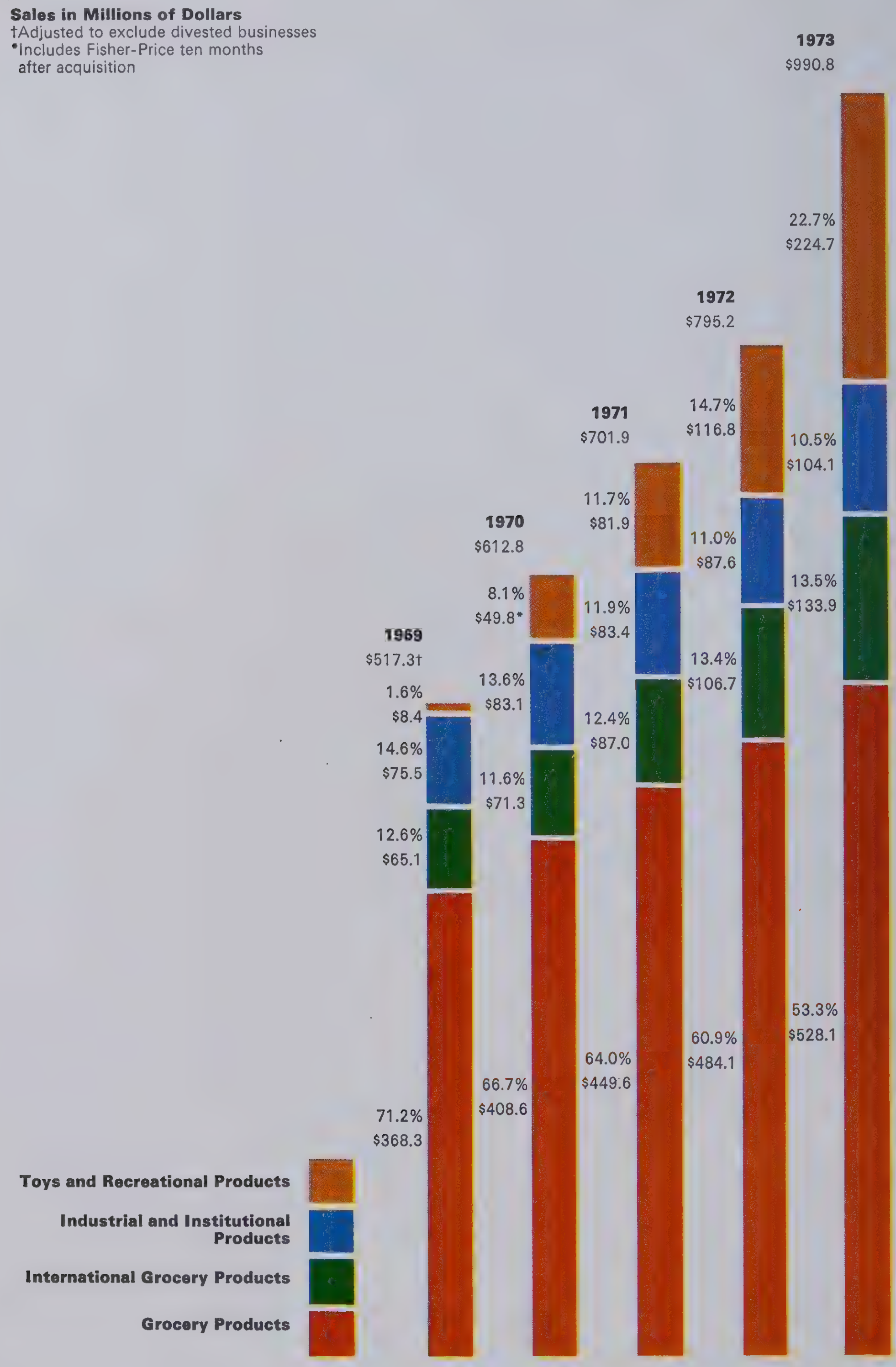
QUAKER

Interim Report Three Months and Six Months Ended December 31, 1973

QUAKER

The Quaker Oats Company

Consolidated Sales Growth by Operating Groups



Financial Summary

Year Ended June 30	1973	1972(A)	Percent Increase (Decrease)
	Thousands of Dollars		
Net sales	**$990,767**	$795,240	**24.6**
Income before income taxes	**85,549**	70,556	**21.2**
Net income	**42,123**	35,614	**18.3**
Preferred dividends declared	**452**	484	**(6.6)**
Common dividends declared	**14,711**	13,006	**13.1**
			Per Share
Net income per common share	**$2.04**	$1.78	**14.6**
Preferred dividends declared	**3.00**	3.00	**—**
Common dividends declared	**.72**	.68	**5.9**
			Common Stock
Average shares outstanding	**20,465,855**	19,759,856	**3.6**

(A) Results for 1972 are restated to reflect the July 20, 1972, merger with Needlecraft Corporation of America, recorded as a pooling of interests.

Annual Meeting

Shareholders are cordially invited to attend the Company's Annual Meeting, which will be held at 9 a.m., Wednesday, November 14, 1973, in the Assembly Room, sixth floor, The Northern Trust Company, 50 South LaSalle Street, Chicago, Illinois. A notice of this meeting together with the form of proxy and proxy statement will be mailed to shareholders on or about October 1, 1973, at which time proxies will be solicited by management.

To All Shareholders and Employees:

Sales and earnings reached new highs in the year ended June 30, 1973. Sales were up 24.6 percent to $990,767,000, and per-share earnings improved 14.6 percent to $2.04. For the most recent five-year period, our annual increase in per-share earnings has averaged 13 percent. The past year was highlighted by:

☐ Fine growth in sales and earnings by all four of our operating groups;

☐ A good increase in the earnings of our large U. S. and Canadian grocery products business, aided by a particularly fine sales performance in the last months of the year;

☐ Substantial expansion in toys led by another outstanding year by Fisher-Price and very good results from the new Marx Toys subsidiary;

☐ An outstanding year in our international grocery products business;

☐ Excellent growth in specialty chemicals;

☐ Substantially higher raw material and transportation costs, many of which were not offset by price increases—particularly in foods.

More important than any of the individual highlights, however, is the overall long-range company strength that was demonstrated. The strategic changes effected throughout the Company in recent years were most important in fiscal 1973, and are very positive factors for the future.

Growth

In operating the business under price controls and major cost increases that are not fully recoverable, we are obviously seeking efficiencies and improvements in productivity that will help immediate results. It is important for you to know that we are managing principally for the long term.

Capital expenditures for facilities that make growth possible were up 25 percent to $52.6 million in fiscal 1973, and we expect them to increase significantly again in the current year. Research expenditures were up 28 percent, and will also increase significantly this year.

These capital investments and research expenditures are concentrated in areas of high growth for Quaker—toys, pet foods, ready-to-eat cereals, frozen foods, and specialty chemicals. In most of these areas we achieved market share gains in the past fiscal year.

The continued strength of the Company's financial position facilitates taking advantage of all business opportunities as they arise. The proceeds of the sale of 600,000 common shares last fall added to our financial resources.

While growth of the business *internally* has been very good, we also have accomplished much in growth from *external* sources. The acquisition of Marx Toys was completed at the close of fiscal 1972. During fiscal 1973: we entered the art needlecraft business with an acquisition in July; in the same month a manufacturer of quality puzzles and games was acquired in The Netherlands; a small Venezuelan manufacturer of specialty cleaning products was acquired in April; and joint grocery products ventures were established in France and Italy.

After the close of the year, we acquired the leading manufacturer of consumer-branded sardine products in Brazil.

Needless to say there were some disappointments. Our venture in the candy business, which we had hoped would be a good growth opportunity, did not meet profitability objectives and was divested at mid-year to

eliminate further losses. Our U. S. cat food business again was unsatisfactory, largely because of a lack of new products. Profitability was also below expectations in the new Needlecraft Division.

On balance, fiscal 1973 showed excellent progress in the areas where we have our highest priorities:

- ☐ Distinctive, high-value consumer products and services with attractive growth and brand leadership potential,
- ☐ High-technology specialty chemicals.

People and Public Responsibility

Business has many dimensions beyond the return on its assets and the successful production of goods and services. Fundamentally, any business is only as good as the people who devote themselves to it. I believe we have outstanding people, and in every way it is our intention to treat them in accord with their excellence.

Business also has an obligation to be useful to society in ways beyond producing good products, providing employment and paying taxes. It has long been our goal to be among the corporate leaders in public responsibility. Many Quaker programs have that specific purpose, and it is part of our objective in everything we do. The Public Responsibility Committee of the Board of Directors reviews these matters regularly.

Food Economy

In the international food economy, there have been poor crops in important agricultural countries, low levels of fish catches which supply protein for animal feed, and dollar devaluation that has made U. S. commodities relatively inexpensive for other countries. At the same time there has been rapidly rising demand for protein foods in economically developed countries and famine in some other countries. These and other circumstances have created extreme demand on U. S. agricultural supplies, resulting in soaring costs for raw materials and many shortages.

These problems have been compounded in the U. S. by attempts to "manage" supply and demand with economic controls that have created major distortions. In some cases, these distortions have in turn created a short-term need for additional controls on commerce, which we have advocated to assure adequate supplies and reasonable price stability for the transition to ending controls. In the longer view, U. S. policy must include early removal of all wage and price controls, full utilization of the resources of American agriculture, and reasonably unrestricted international commerce as soon as possible. These approaches seem to be gaining wider recognition by U. S. policy makers, which is encouraging.

Quaker Outlook

National and international commodity inflation in foods and price controls are affecting profit margins in our grocery businesses, and will restrict earnings in the early part of the current fiscal year. We believe that the corporate-wide results achieved in fiscal 1973, however, indicate the inherent strengths of our diversified businesses. Thus, despite temporary distortions, the long-term outlook for achieving our earnings objective is excellent.

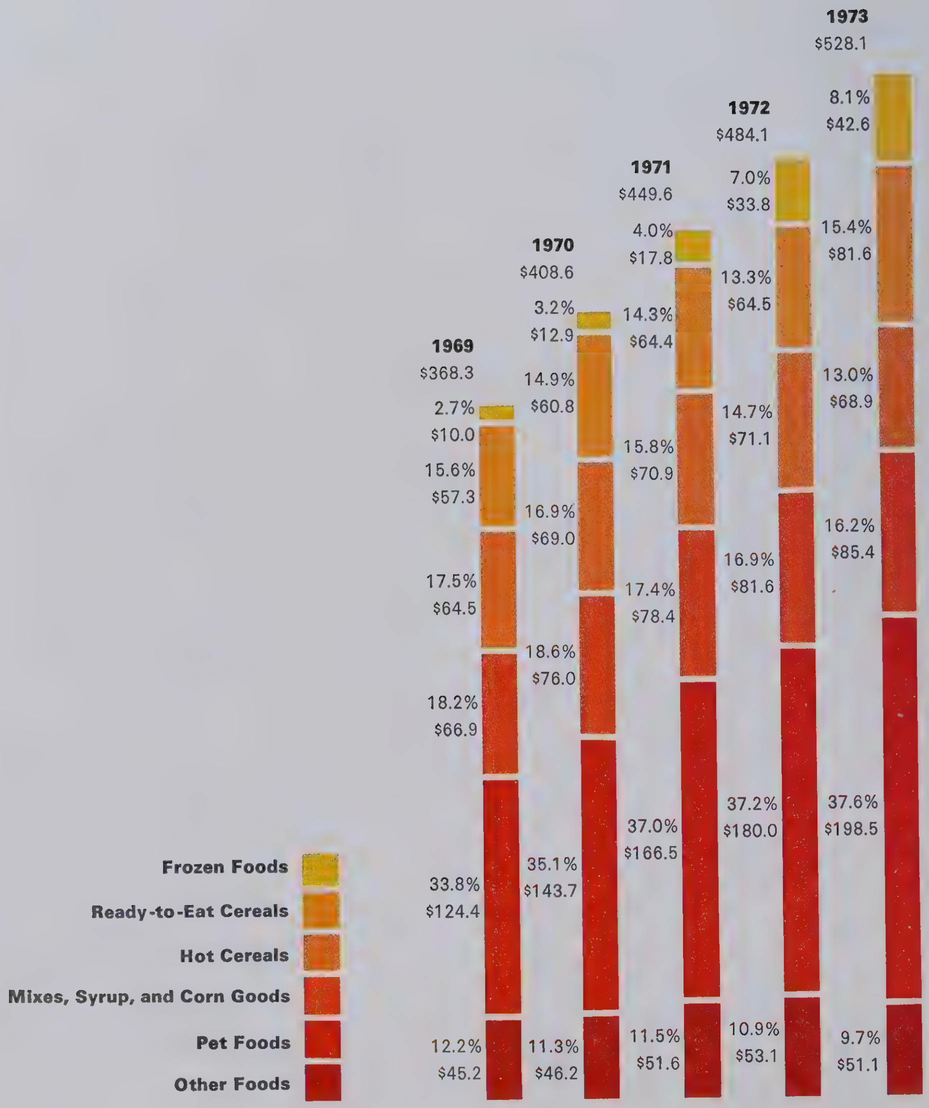
Robert D. Stuart Jr.

Robert D. Stuart, Jr.
President and
Chief Executive Officer

September 6, 1973

Grocery Products Group

Sales in Millions of Dollars



The Grocery Products Group, the largest factor in Quaker's business, set new sales and profit records in fiscal 1973. Grocery sales in the U. S. and Canada were $528.1 million, up 9.1 percent, while operating income increased significantly, up 17.5 percent, despite price controls and higher commodity costs. Very good sales increases and some reduction of marketing expenses toward the end of the fiscal year aided the earnings improvement. Most important, Quaker's grocery brands continued to show fine vitality.

Cereals and Mixes Division

Quaker's ready-to-eat cereal business had excellent growth during fiscal 1973, with sales up 27 percent, reflecting good market-share improvement at a time when industry sales were also up significantly. Quaker 100% Natural Cereal, a distinctively new and different product introduced in 30 percent of the United States last fall, has been very well accepted by consumers.

The Cap'n Crunch line of ready-to-eat cereals achieved its highest sales and market share. A new flavor, Cinnamon Crunch, is being introduced nationally.

Life cereal progressed very well, aided by new advertising that emphasizes the appeal of this nutritious product to children. King Vitaman increased volume somewhat, although at year-end its sales were below expectations.

There was little change during the year in the status of the Federal Trade Commission's charges that Quaker and three larger manufacturers of ready-to-eat cereals participate in a shared monopoly. The Company continues to believe the charges against it are without any merit.

Sales of hot cereals—traditional Quaker Oats and Instant Quaker Oatmeal—were off slightly.

Aunt Jemima pancake mixes and syrup both increased sales over the prior year by maintaining their shares of expanding industry sales. The significant business in grits and corn meal continued strong.

Quaker's cereals and mixes, which have always been economical foods, are expected to be particularly attractive to consumers as a source of good nutrition at modest cost at a time when some alternative foods have become relatively expensive.

Frozen Foods Division

Sales increased 26 percent during the year. Investment in the development of this business continued, but at a lower rate than in previous years.

Aunt Jemima Blueberry Waffles were successfully introduced, and a new flavor—Cinnamon Swirl—was added to the Frozen French Toast line.

Frozen prepared Lasagna and Pepperoni and Deluxe Pizzas were added to the Celeste line of Italian specialties, and the Celeste brand became the market leader in frozen pizza in the more than 50 percent of the United States where it is available.

Pet Foods Division

Ken-L Ration semi-moist dog food products, which had strong market-share gains, were the main contributors to record sales—up more than 10 percent. The Ken-L Ration brand of canned dog food increased sales and continues to lead the maintenance canned dog food market.

Sales and market share of Puss 'n Boots cat food declined in fiscal 1973, reflecting a lack of new products during the year. Every effort is being made to correct this deficiency.

Strong research and development programs in both dog and cat food are under way at the Company's pet food research facilities in Barrington, Illinois, in order to support the Ken-L Ration and Puss 'n Boots brand franchises with innovative new products.

Canada

The Quaker Oats Company of Canada Limited performed very well in fiscal 1973. Strong growth in pet foods and good cost control across all operations combined to produce the best year in the Canadian company's history.

Several important new products were successfully introduced, including Harvest Crunch—similar to Quaker 100% Natural Cereal in the U. S.—and Puss 'n Boots Flavour Morsels, a semi-moist cat food. Blueberry Waffles were also added to the Aunt Jemima line of frozen, prepared products.

Group Outlook

As pointed out in the President's letter there are a number of factors related to international food demand and U. S. economic policy that raise some uncertainties about the Group's results in the 1974 fiscal year. There will be problems in both the cost and availability of raw materials and difficulties in increasing prices to recover costs. Yet, despite this short-term problem, the fundamentals of the business are very strong, as demonstrated in fiscal 1973.

The growth and progress of the Toys and Recreational Products Group reflects the successful achievement of an important corporate objective—a broadened base in consumer products. This Group now accounts for about a quarter of total sales and a third of consolidated operating income.

Group sales were $224.7 million in fiscal 1973, up more than $107 million from the prior year, and reflecting the first year of the addition of Marx Toys and substantial growth from Fisher-Price and Needlecraft.

In looking at the sales bar chart on the next page, please keep in mind that Fisher-Price was purchased in September, 1969; Marx was purchased in June, 1972; and Needlecraft was merged in July, 1972.

Fisher-Price Toys Division

The first and largest division in the Group is Fisher-Price, which is acknowledged to be the leading producer of quality toys for the pre-school market. The division's sales advanced 23 percent, and profits improved at a highly satisfactory rate.

A mainstay of Fisher-Price's success is its excellent product development capability, which is fundamental to the creation of toys that continue in heavy demand year after year. In fiscal 1973, the division added 20 new products, many of which are expected to be *staples*—products that retain their popularity over many years.

A significant development was the introduction of the Crib & Playpen line of toys for infants, the early success of which signifies that Fisher-Price will be participating importantly in a broader segment of the market for children's products.

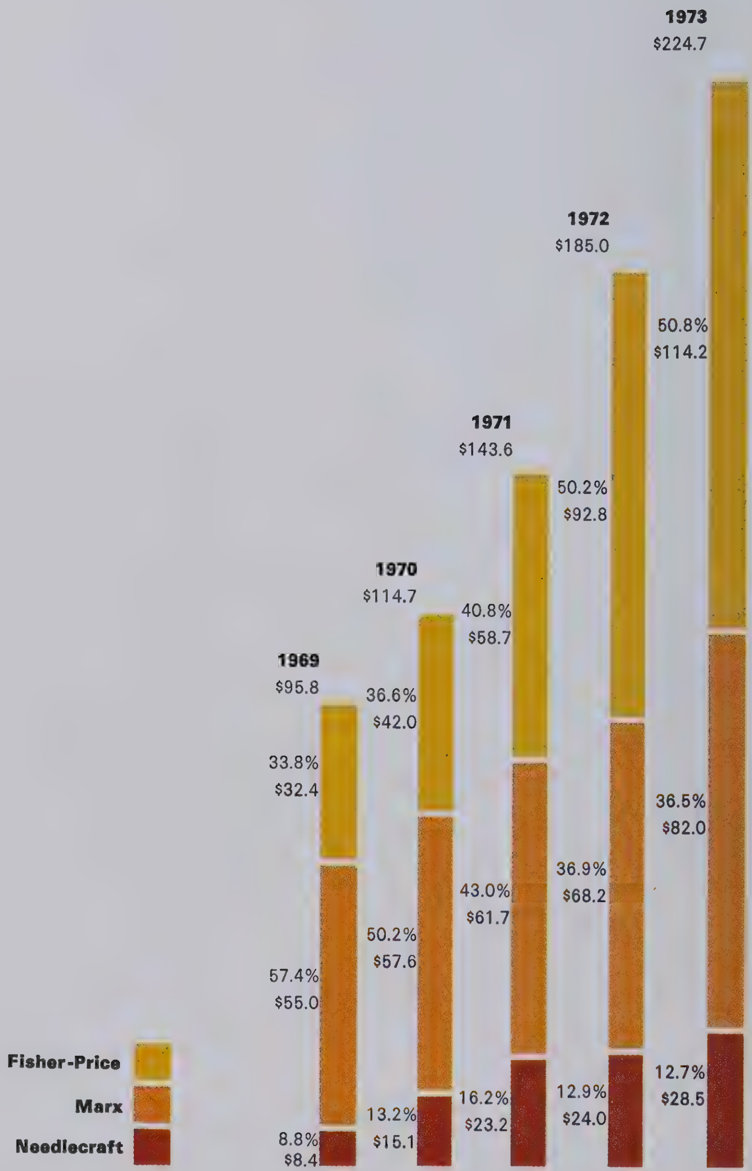
Other promising products introduced during the year include new action games for preschoolers, as well as an appealing hand-operated Movie Viewer that shows Walt Disney and Sesame Street films. The Play Family Village and Play Family Camper are among this year's additions to the extremely successful Play Family line.

A major opportunity for expanded sales exists in the Common Market countries of Europe, where the quality and imagination of Fisher-Price toys are expected to have strong and widespread appeal. Fisher-Price Toys Ltd., with responsibility for marketing in the United Kingdom and on The Continent, completed its first full year of operation, and sales were very good.

Steinmeier & Co., N.V., in The Netherlands, the manufacturer of Simplex children's puzzles and games sold principally in Europe, was acquired in July, 1972. A new plant facility was built at Kaulille, Belgium, which will allow for the expansion of this subsidiary.

Toys and Recreational Products Group

Sales in Millions of Dollars



Includes the following sales prior to purchase acquisition:

	1969	1970	1971	1972
Fisher-Price	$32.4*	$ 7.3	—	—
Marx	$55.0	$57.6	$61.7	$68.2

*January 31 fiscal year

An important factor in the successful growth of Fisher-Price in recent years is the extensive expansion of manufacturing, distribution and research facilities required to support a sales growth rate that has averaged 38 percent a year since the division was acquired by Quaker in 1969. In the North American business, new plants at Brownsville, Texas, and Matamoros, Mexico, and substantial additional warehouse and plastic molding facilities at Medina, New York, were completed. A new plant at Murray, Kentucky, is nearing completion, and a doubling of research and development facilities at the division's research center in East Aurora, New York, is well under way.

Marx Toys Division

Sales and profits were ahead of expectations in fiscal 1973.

The division made several additions to its management team during the year, adding Fisher-Price, Quaker and other executives to the core of experienced Marx people.

The Marx Big Wheel, the established, highly successful riding toy for young boys and girls, was further improved with the addition of a child-appealing saddle bag and a new hand brake. Additionally, several new products were introduced during the year, including some action games and several very promising riding toys.

Advertising, promotion and packaging of Marx products also were revamped to focus attention on the name *Marx* as a symbol for quality and durability. A new slogan, "If we make it, it can take it," is now being used in all Marx advertising. Significant parts of Marx television advertising and all of its new print advertising are now directed to parents.

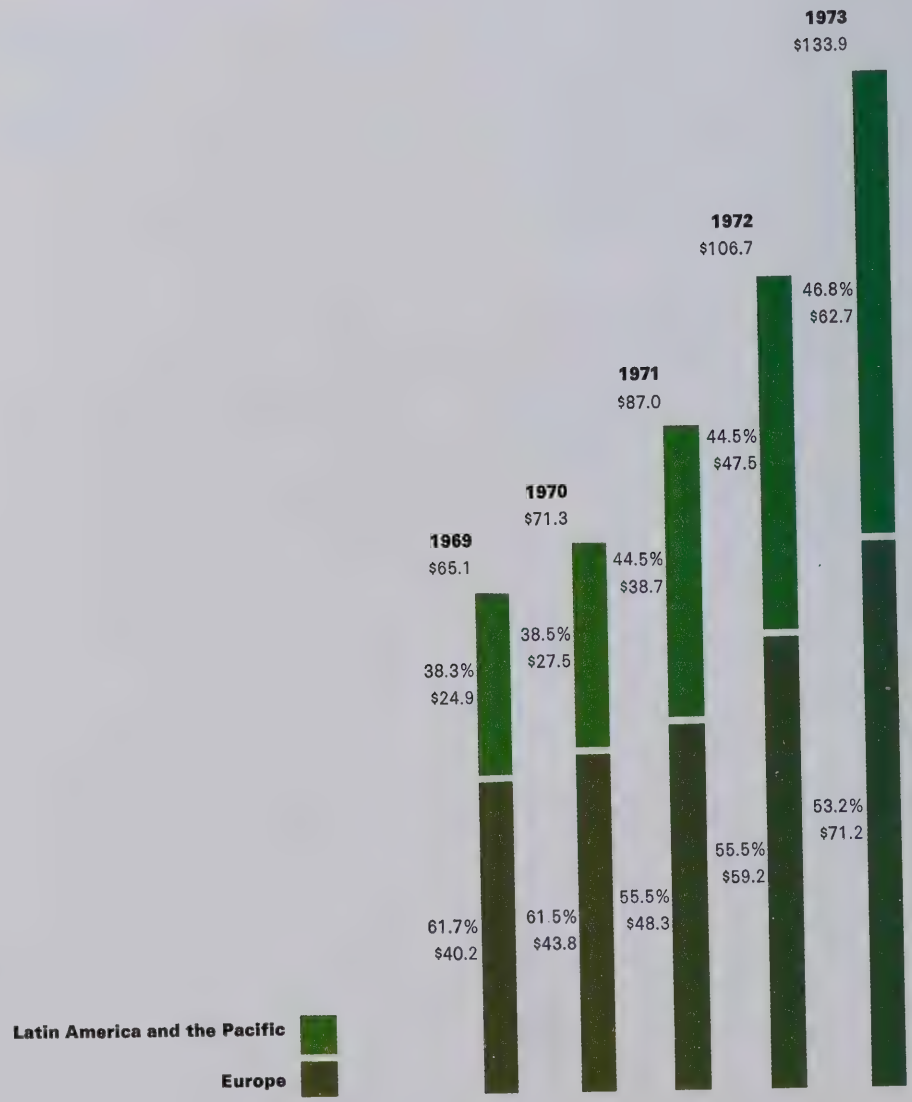
Needlecraft Division

Division sales advanced considerably during the fiscal year and provided an important position for Quaker in the expanding art needlecraft field. However, a significant shift in consumer preference for synthetic rather than wool yarns contributed to lower margins. New synthetic yarn plant start-up expenses and related costs exceeded expectations as the fiscal year progressed. Profitability was reduced, and operating results were disappointing.

With volume up in all three segments of the division (yarn, kits and mail order), Quaker continues to be optimistic about the potential of the business. Newly designed products have been added, the new Herrschners mail order catalog has been substantially improved, and efforts are being made to improve margins.

International Grocery Products Group

Sales in Millions of Dollars



Good increases in all countries where the International Grocery Products Group does business produced a 25.5 percent improvement in fiscal 1973 Group sales, which increased to $133.9 million. Operating income was up 28.3 percent, even after investments in new product introductions that were larger than in recent years, and price control limitations.

Europe

Based on the growth potential for pet foods in European countries and Quaker's strong position in pet food technology, successful steps were taken to expand these products in the United Kingdom, Scandinavia, the Benelux nations, France, and Italy.

In the United Kingdom, Chunky Minced Morsels, a semi-moist product similar to Ken-L Ration Burger in the U. S., was largely responsible for doubling Quaker's dog food business there over the last two years.

The Company's position in the important French pet food market was strengthened by forming a joint venture with Unipol, S.A., a leading producer and marketer of vegetable oil and related products. Entry into the Italian pet food market is under way through a joint venture with Chiari and Forti, S.p.A., which has the leading brands of vegetable oil in Italy and a strong sales force.

Quaker's other businesses in ready-to-eat and hot cereals, mixes and other grocery lines continued to make progress during the year.

Latin America and the Pacific

Several years ago, Quaker set out to selectively strengthen some relatively small but long-established international businesses so the companies would become more viable in the countries they serve, and their performance would meet corporate standards. In fiscal 1973 Fabrica de Chocolates La Azteca in Mexico, acquired in 1970, showed excellent improvement, aided by expanded distribution and stronger advertising and merchandising programs.

Acquisitions were completed in recent months in Brazil and Venezuela. Tempus, S.R.L., producer of the market-leading Nevex brand of specialty laundry and cleaning products in Venezuela, was purchased in April to give additional marketing scale and significance to the Company's existing business.

In July, after the close of the 1973 fiscal year, Conservas Coqueiro, S.A., the leading processor of branded sardines in Brazil, was acquired. This business is expected to add significant strength to the Group's ability to grow successfully in the dynamic Brazilian market.

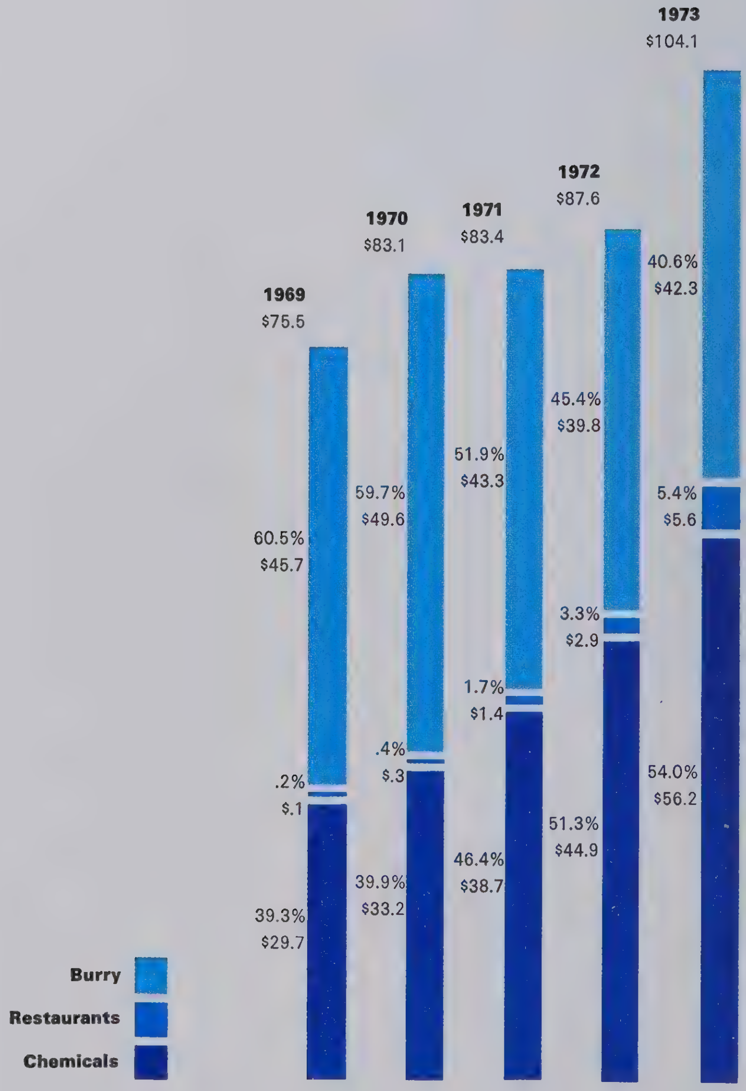
In Australia, following the acquisition of Luv pet foods in fiscal 1972, Quaker's market position in canned products improved significantly, and semi-moist dog food, under the Luv Mince for Dogs brand, was successfully introduced and is being extended nationally.

Looking Ahead

With the steady expansion of the International Grocery Products businesses through internal growth, joint ventures, and acquisitions, the necessary scale for increased marketing capability and improved operating efficiency is being achieved. Local management is being strengthened. The larger, more viable businesses should be able to turn in better operating performance, as indicated in fiscal 1973 results, while providing superior products to consumers in the respective countries.

Industrial and Institutional Products

Sales in Millions of Dollars



Substantial increases in both sales and operating income were achieved by Industrial and Institutional Products during fiscal 1973. Sales were $104.1 million, up 18.8 percent, and operating income improved 19.6 percent.

Chemicals Division

More than half the sales and most of the operating income of the Group were generated by the Chemicals Division, which manufactures furan chemicals—specialty products with a variety of applications in the metal casting, petroleum, plastics and rubber industries. Most of these applications involve high technology, in which Quaker products are used for their unique properties rather than as chemical commodities.

Good results for the year reflected strong performance in both the U. S. and Europe. Business in the United Kingdom was static early in the year, but improved considerably by year-end.

Furfuryl alcohol continues to provide significant growth. It is being used by an increasing number of foundries in Europe and the United States as a sand-mold binder, because of its value in reducing costs and improving plant flexibility.

A new furfuryl alcohol plant at Geel, Belgium, was opened during the fiscal year, as were new chemical research facilities at Quaker's principal research site at Barrington, Illinois. Construction has recently begun on a $7 million addition to the furfural plant at Belle Glade, Florida, to meet stepped-up demand for furfural, furfuryl alcohol and other furan chemicals.

During fiscal 1973, the division introduced Quacorr, a specialty resin that gives excellent corrosion resistance and fire-retardant properties to fiberglass-reinforced plastics in the chemical process industries.

There are impressive worldwide opportunities in this high-technology specialty chemicals business. The commitment of further significant capital resources to provide additional capacity is planned.

Burry Division

Burry achieved further improvement in operating income on a modest sales increase, and succeeded in maintaining its margins in a period when costs were rising rapidly.

A new packaging program was completed for food-store cookies, and several new cookie products were introduced on the East Coast, where retail marketing is concentrated. Imaginative new packaging for Girl Scout cookies enhanced the division's reputation as a leading supplier of cookies produced for sale by member councils of the Girl Scouts of the U. S. A.

Efficiencies achieved at Burry's one manufacturing plant have been considerable, but escalating flour costs will be a problem for the division in fiscal 1974.

Restaurants Division

Four new Magic Pan restaurants were opened during the fiscal year—just outside Chicago and in New York, Atlanta and Philadelphia. There are now ten of these créperies in cities across the United States. Volume for the fiscal year was excellent, exceeding expectations.

Though this specialty restaurant business is still extremely small in relation to other operating divisions, progress to date is encouraging and is the basis for investment in additional locations in fiscal 1974.

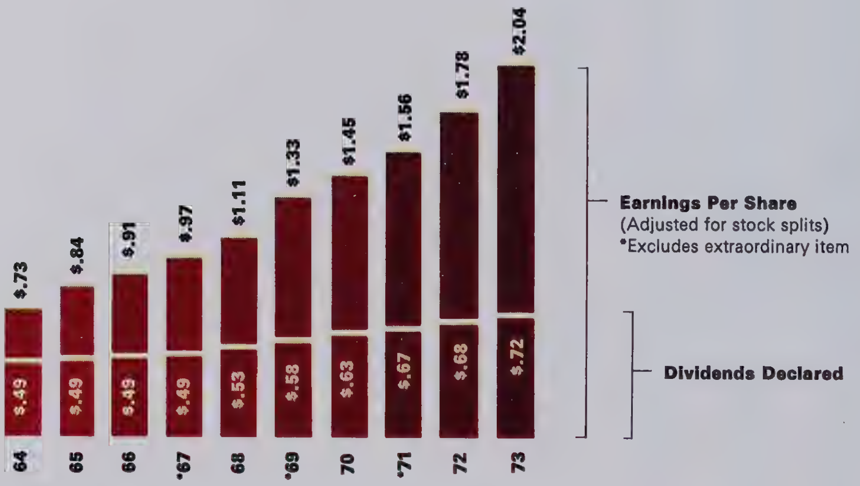
Financial Information

Growth in Earnings Per Share:

Since 1969 it has been Quaker's financial objective to improve per-share earnings an average of at least 10 percent a year over any five-year period, and this objective has been achieved. The reason for stating the goal as a five-year moving average is that the business is managed principally for long-term results. Most individual years should be more than 10 percent ahead, but this approach also contemplates that some years may be below it. Five-year averages (restated for the merger with Needlecraft) are:

5-Year Periods Ending June 30	5-Year Average Per-Share Earnings Improvement
1969	12.8%
1970	11.6%
1971	11.5%
1972	13.0%
1973	13.0%

This chart shows actual earnings-per-share data and dividends declared for the last ten fiscal years:



Stock Split and Dividend Increase:

The Company's common shares were split 3-for-2, effective September 22, 1972. The quarterly common share dividend was increased to 18 cents a share, effective with the payment on October 20, 1972.

Sales and Operating Income by Groups:

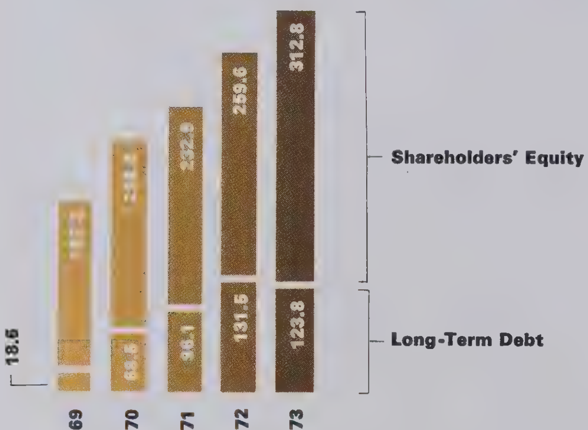
There were significant upward trends in all four operating groups, as discussed in the respective Group sections earlier in this report. Particularly important is the planned improvement in the Grocery Products businesses. Actual data is:

		Millions of Dollars	
Year Ended June 30	**1973**	1972	1971
Sales*			
Grocery Products Group	**$528.1**	$484.1	$449.6
International Grocery Products Group	**133.9**	106.7	87.0
Toys and Recreational Products Group	**224.7**	116.8	81.9
Industrial and Institutional Products Group	**104.1**	87.6	83.4
Total	**$990.8**	$795.2	$701.9
Operating Income*			
Grocery Products Group	**$ 51.1**	$ 43.5	$ 43.2
International Grocery Products Group	**6.8**	5.3	5.2
Toys and Recreational Products Group	**31.9**	22.8	13.6
Industrial and Institutional Products Group	**6.7**	5.6	4.3
Total	**$ 96.5**	$ 77.2	$ 66.3
Less interest expense (net)	**11.0**	6.6	5.5
Income before income taxes	**$ 85.5**	$ 70.6	$ 60.8

*Prior years' data is restated to reflect the 1973 shift of organizational responsibility for industrial and governmental cereals business from the Industrial and Institutional Products Group to the Grocery Products Group, and refinements in the allocation of certain costs between groups.

Financing

The Company continues to maintain a strong, flexible financial condition. Quaker policy is to make aggressive use of borrowing and, at the same time, maintain the ability to take full advantage of unforeseen investment opportunities.
In accord with these concepts, the Company expects its debt ratio will be maintained between 25 and 35 percent. The chart below shows shareholders' equity and long-term debt at the end of each of the last five fiscal years. At June 30, 1973, long-term debt was 28.4 percent of the total.



Early in the fiscal year, the Company sold 600,000 shares of additional common stock, thus adding an additional $22.6 million of equity to the permanent capital base for use in financing future working capital and fixed asset requirements. Also, in January, a $20.2 million, seven-year financing transaction was arranged to provide for the anticipated needs of foreign operations.

In addition to its permanent capital requirements, the Company also incurs short-term borrowings from banks and in the commercial paper market, primarily in connection with seasonal working-capital requirements. In fiscal 1973, these domestic seasonal working capital requirements reached a peak of $42 million in October, were reduced to $4 million in January, and increased again to $49 million at June 30.

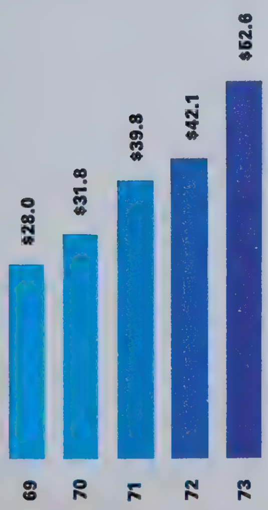
Return on Shareholders' Equity

The Company recognizes that return-on-investment goals must be basically long-term in nature, and that the results of new investments are often unfavorable on short-term earnings. Overall, however, Quaker expects that its diversified businesses should be able to support a regular flow of substantial new investments on which long-term returns are favorable. This concept is reflected in the table below, which shows the after-tax return on shareholders' equity during each of the past five years.

Return on Shareholders' Equity
*Excludes extraordinary item

Capital Expenditures

Quaker continues to invest substantial amounts to support future growth. Excluding acquisitions, capital expenditures in fiscal 1973 were $52.6 million, and have increased at an average annual rate of about 18 percent during the last five years. Principal spending last year was for new facilities to manufacture toys, pet foods, frozen foods, chemicals and ready-to-eat cereals.

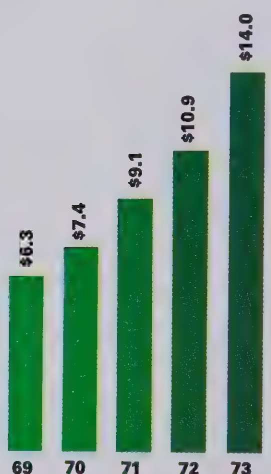


Capital Expenditures
Millions of Dollars

Research and Development

Technical research expenditures were $14 million in fiscal 1973. This represents scientific research and development, the creation of new products and improvement of current products, and the centralized coordination of quality assurance. The figures do not include market research nor the bulk of quality assurance expenditures, which occur at divisional and plant levels.

Quaker continues a heavy emphasis on technical research, seeking those products that will possess lasting, distinctive consumer benefits as well as new applications of specialty chemicals. These expenses have increased at a rate of more than 19 percent a year over the last five years.



Technical Research
Millions of Dollars

The Quaker Oats Company and Subsidiaries
Consolidated Statement of Income and Reinvested Earnings

	Thousands of Dollars	
Year Ended June 30	**1973**	1972
Revenues:		
Net sales	**$990,767**	$795,240
Other income—net	**1,818**	1,702
	992,585	796,942
Costs and Expenses:		
Cost of goods sold	**692,723**	545,783
Selling, general and administrative expenses	**201,460**	172,409
Interest expense	**12,853**	8,194
	907,036	726,386
Income before income taxes	**85,549**	70,556
Provision for income taxes	**43,426**	34,942
Net income	**42,123**	35,614
Reinvested Earnings:		
Balance beginning of year	**187,561**	162,805
Needlecraft Corporation	**—**	2,632
	187,561	165,437
Dividends—preferred stock	**(452)**	(484)
—common stock	**(14,711)**	(13,006)
Transfer to common stock re stock split	**(29,911)**	—
Balance end of year	**$184,610**	$187,561
Per Common Share: (A)		
Net Income	**$2.04**	$1.78
Dividends Declared	**$ .72**	$ .68
Average common shares outstanding	**20,465,855**	19,759,856

(A) Adjusted for stock split on September 22, 1972.

See accompanying notes to financial statements.

Consolidated Balance Sheet

Assets	Thousands of Dollars	
June 30	**1973**	1972
Current Assets:		
Cash	**$ 3,038**	$ 8,009
Marketable securities, at cost which approximates market	**23,316**	15,326
Receivables (less allowances of $3,546,000 and $2,613,000 respectively)	**111,218**	91,468
Inventories	**169,607**	126,732
Prepaid expenses	**6,631**	6,173
Current assets	**313,810**	247,708
Other Receivables and Investments:	**6,903**	5,575
Property, Plant and Equipment, at cost:		
Land	**7,276**	7,092
Buildings and improvements	**113,284**	101,544
Machinery and equipment	**253,564**	234,526
	374,124	343,162
Less accumulated depreciation (including reserve for estimated losses on plant dispositions of $4,020,000 in 1972)	**102,047**	99,234
Properties (net)	**272,077**	243,928
Intangible Assets:		
Excess of cost over net assets of acquired businesses	**30,004**	27,747
Patents, trademarks, designs, less amortization	**7,276**	7,751
	$630,070	$532,709

See accompanying notes to financial statements.

Liabilities and Shareholders' Equity

June 30	Thousands of Dollars 1973	1972
Current Liabilities:		
Notes payable to banks	**$ 21,685**	$ 14,558
Commercial paper	**44,208**	21,550
Current maturities of long-term debt	**3,447**	4,285
Accounts payable and accrued expenses	**78,050**	67,511
Income taxes payable	**6,501**	5,337
Dividends payable	**3,823**	3,449
Current liabilities	**157,714**	116,690
Long-term Debt, less current maturities:		
3½% Notes, $2,000,000 due annually through 1977	**6,000**	8,000
Revolving credit notes, due 1979	**14,200**	37,000
Note payable, due 1980	**20,188**	—
6½% Note, $1,250,000 due annually from 1975 through 1994	**25,000**	25,000
7.70% Sinking fund debentures, $1,800,000 due annually from 1977 through 2001	**50,000**	50,000
Obligations of subsidiaries	**8,433**	11,521
Long-term debt	**123,821**	131,521
Other Liabilities:	**6,090**	2,270
Deferred Income Taxes:	**29,650**	22,613
Shareholders' Equity:		
Preferred, $50 par value, $3 cumulative convertible, authorized 153,897 shares; issued 148,165 and 158,899 shares, respectively	**7,408**	7,945
Common, $5 par value, authorized 35,000,000 shares; issued 20,892,858 and 20,131,533 shares, respectively	**104,464**	67,105
Additional paid-in capital	**22,359**	3,350
Reinvested earnings	**184,610**	187,561
	318,841	265,961
Less treasury common stock, at cost	**6,046**	6,346
Shareholders' equity	**312,795**	259,615
	$630,070	$532,709

Consolidated Statement of Changes in Financial Position

	Thousands of Dollars	
Year Ended June 30	**1973**	1972
Sources of Working Capital:		
Operations:		
Net Income	**$42,123**	$35,614
Depreciation and amortization	**21,114**	15,587
Deferred income taxes	**7,037**	6,210
Total from Operations	**70,274**	57,411
Issuance of 600,000 shares of common stock	**22,622**	—
Proceeds from long-term borrowings	**20,188**	37,000
Increase in other long-term liabilities	**3,820**	1,300
Sales of properties	**3,904**	1,926
Common stock issued under stock option plans	**3,848**	4,337
Total provided	**124,656**	101,974
Uses of Working Capital:		
Additions to properties	**52,576**	42,071
Cash dividends declared	**15,163**	13,490
Decrease in long-term debt	**27,888**	2,168
Excess of cost over working capital of acquired businesses	**2,673**	22,253
Other—net	**1,278**	1,623
Total used	**99,578**	81,605
Increase in Working Capital:	**$25,078**	$20,369
Consisting of:		
Cash and marketable securities	**$ 3,019**	$ (11,879)
Receivables—net	**19,750**	26,293
Inventories	**42,875**	35,363
Prepaid expenses	**458**	(1,975)
Notes payable to banks	**(7,127)**	6,222
Commercial paper	**(22,658)**	(21,550)
Current maturities of long-term debt	**838**	(1,781)
Other current liabilities	**(12,077)**	(10,324)
Net increase	**$25,078**	$20,369

See accompanying notes to financial statements.

The Quaker Oats Company and Subsidiaries

Notes to Financial Statements

Summary of Accounting Policies

Consolidation The consolidated financial statements include The Quaker Oats Company and all subsidiaries. Investments in 20% to 50% owned companies are stated on the equity basis. All significant intercompany accounts and transactions are eliminated.

Foreign currency items are translated into U. S. dollars at year-end exchange rates for assets and liabilities and average annual exchange rates for income items, except property, plant and equipment and related depreciation, which are translated at rates in effect at time of acquisition.

Unrealized translation gains are credited to a reserve; unrealized losses in excess of previously established reserves are charged to income.

Intangibles Excess of cost over net assets of acquired businesses represents the amount paid in excess of the fair values of the net assets of such businesses. Such costs are considered to represent continuing values and are reduced if diminution of continuing values of underlying businesses is indicated. As required by current accounting rules, any such costs resulting from acquisitions after October 31, 1970, are amortized over periods not in excess of 40 years.

Costs incurred in acquiring patents, trademarks, designs, etc., are amortized on a straight-line basis over their estimated useful lives.

Inventories Inventories are based on physical quantities priced at the lower of cost (first-in, first-out for toys and recreational products and principally average annual cost for other products) or market.

Depreciation and Properties Depreciation is provided in the accounts using the straight-line method over estimated useful lives of the properties. For tax purposes, depreciation is provided on the basis of accelerated rates as provided by applicable laws and regulations. At the present time, depreciation for tax purposes exceeds straight-line depreciation, and deferred tax liability is provided for the related taxes.

The composite method is used for depreciation, and only abnormal gains and losses on sales or abandonments of property are included in income.

Research and Development Costs are expensed as incurred.

Advertising Costs are expensed as incurred.

Tax Credits Beginning in 1972, investment tax credits are deferred and amortized over the estimated useful lives of the related assets.

Undistributed Foreign Earnings Except for minor amounts, no Federal income taxes have been provided on the undistributed net earnings of foreign subsidiaries because such earnings are expected to be permanently invested in those countries. If such earnings were distributed, U. S. income taxes would be substantially offset by available tax credits.

Pension Plans The provision charged to earnings each year is sufficient to cover normal costs of the plans of the Company and its subsidiaries and, for the principal plans, amortization of prior service costs over 40 years or less.

Investments in Foreign Operations

Included in the Consolidated Financial Statements for the years ended June 30, 1973 and 1972, are the following:

	Thousands of Dollars	
	1973	1972
Net Assets:		
Canada	**$16,433**	$14,839
Europe	**33,471**	27,160
Latin America and Pacific	**25,903**	20,458
Net Sales:		
Canada	**$57,440**	$52,559
Europe	**93,727**	75,027
Latin America and Pacific	**69,699**	44,685
Reinvested Earnings:	**$41,326**	$33,496

Acquisitions

Louis Marx & Co., Inc., a toy manufacturer, was acquired June 30, 1972, for $51,346,000 in a purchase transaction. Its assets and liabilities as of June 30, 1973 and 1972, are included in the accompanying consolidated balance sheets, and its results of operations are included in the consolidated statement of income beginning in 1973. The $15,067,000 excess of cost over net assets acquired has been allocated to property, plant and equipment and patents, trademarks, designs, etc., at fair values, based on independent appraisals.

Needlecraft Corporation of America, Inc., a manufacturer and distributor of yarns, needlecraft kits, etc., with net assets of approximately $4,500,000, was acquired June 20, 1972, by issuance of 637,220 shares (restated for stock split) of the Company's common stock, in a transaction accounted for as a pooling of interests. The consolidated financial statements for 1972 have been appropriately restated.

Actual results for 1973 and pro forma results for 1972 of the Company and Marx, after 1972 adjustments for estimated additional depreciation and amortization and interest on debt, are as follows:

	Thousands of Dollars	
	1973	1972
Sales	**$990,767**	$863,437
Net income	**$ 42,123**	$ 36,423
Net income per common share	**$ 2.04**	$ 1.82

In July, 1972, the Company acquired Steinmeier & Co. N.V. (a Dutch toy manufacturer), and in April, 1973, acquired Tempus S.R.L. (a Venezuelan laundry products manufacturer) for approximately $2,243,000 in cash, in purchase transactions. Results of operations of these businesses, which are not material, are included in the Consolidated Statement of Income from dates of acquisition. The related excess of cost over fair values of net assets acquired of $1,093,000 is being amortized over ten years.

In July, 1973, Conservas Coqueiro S.A. (a Brazilian sardine processor) was acquired by the Company for $14,503,000 in cash in a purchase transaction. The results of operations of this business will be included in the Consolidated Statement of Income from date of acquisition.

Excess of Cost Over Net Assets of Acquired Businesses

Excess of cost over net assets of acquired businesses includes $27,620,000 related to acquisitions prior to October 31, 1970, (principally Fisher-Price Toys), which is not being amortized. The balance, relating to acquisitions after that date, is being amortized over periods not exceeding 40 years.

Shareholders' Equity

Stock Options. At June 30, 1973, 557,726 unissued shares of common stock were reserved for issuance upon the exercise of outstanding stock options, and an additional 620,320 unissued shares were available as of that date for granting additional options. Option prices range from $26.83 to $42.82 per share. During the year ended June 30, 1973, options covering 133,090 shares were granted at $42.82 per share, options for 139,623 shares were exercised, and options for 7,203 shares were terminated.

Changes in Capital Accounts Changes in Common stock, Additional paid-in capital and Treasury common stock during 1972 and 1973 are summarized as follows:

Amounts in Thousands of Dollars (deduct)

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Treasury Common Stock Shares	Treasury Common Stock Amount
Balance, June 30, 1971	12,878,007	$ 64,390	$ 1,710	216,825	$ 7,323
Needlecraft Corporation of America pooling of interests	424,813	2,124	(1,643)	—	—
Restated June 30, 1971	13,302,820	66,514	67	216,825	7,323
Stock options exercised and conversions of preferred	118,202	591	3,191	(16,408)	(555)
Sale of common stock to trustee of profit sharing plan	—	—	92	(12,500)	(422)
Balance, June 30, 1972	13,421,022	67,105	3,350	187,917	6,346
Stock options exercised and conversions of preferred	146,646	733	3,093	(804)	(23)
3-for-2 Stock split September 22, 1972	6,725,190	33,626	(3,968)	89,648	—
Additional stock issuance November 1, 1972	600,000	3,000	19,622	—	—
Sale of common stock to trustee of profit sharing plan	—	—	262	(8,200)	(277)
Balance, June 30, 1973	20,892,858	$104,464	$22,359	268,561	$6,046

Other Each share of the $3 cumulative preferred stock is convertible at the holder's option into 2.475 shares of common stock and, after January 1, 1974, may be redeemed by the Company at $58 per share. There were 10,734 shares of preferred stock converted into common during 1973 and 4,300 shares during 1972. At June 30, 1973, there were 366,708 shares of common stock reserved for conversion of the $3 cumulative preferred stock. Preference stock of 1,500,000 shares without par value is authorized but unissued.

Income per common share is based on 20,465,855 and 19,759,856 weighted average shares outstanding during 1973 and 1972, respectively. Any dilution resulting from the exercise of stock options presently outstanding and conversion of preferred stock is not significant.

Under the terms of the note agreements, $59,628,000 of reinvested earnings as of June 30, 1973, was not available for payment of cash dividends and/or certain other distributions to preferred and common shareholders. Minimum working capital of $75,000,000 must be maintained, and consolidated current assets cannot be less than 180 percent of consolidated current liabilities.

Long-Term Debt

The 7.70% debentures provide that on June 15, 1977, and each year thereafter, the Company shall redeem $1,800,000 and may redeem up to an additional $1,800,000 of debentures, both at 100% of principal amount. Debentures may be called at any time at prices decreasing from 107.1% of principal amounts currently to 100% in 1996, except that until June 15, 1981, such redemption cannot be made from the proceeds of any refunding operation having an interest cost of less than 7.70% per annum.

The revolving credit-term loan agreement provides for revolving borrowings from banks of up to $40,000,000 (at ½ of 1% above the prime rate of interest per annum) at the option of the Company until June 30, 1975. On or before that date the Company has the option of converting all or part of the $40,000,000 to a term loan, due June 30, 1979.

In January, 1973, the Company issued a seven-year promissory note in the amount of $20,188,000 in exchange for all the outstanding securities of a foreign financing corporation, the assets of which will be used to provide funds for the anticipated needs of foreign operations. The promissory note bears interest at 1% over the prime rate and is non-callable until 1975.

Income Taxes

Provision for income taxes consists of:

	Thousands of Dollars	
	1973	1972
Currently payable—		
Federal	**$27,310**	$21,647
Investment tax (credit)	**(165)**	(56)
Foreign	**5,580**	3,647
State	**3,664**	3,495
Deferred (related primarily to depreciation and investment tax credits)	**7,037**	6,209
	$43,426	$34,942

Pension Plans

Pension expense totaled $6,510,000 for 1973 and $5,376,000 for 1972 under plans of the Company and its subsidiaries. Pension expense is funded currently. Pension funds are in excess of the actuarially computed value of the vested benefits.

Litigation

In April, 1972, the Federal Trade Commission filed charges against four manufacturers of ready-to-eat cereals, including the Company, alleging that between them they share a monopoly in the business. In the opinion of the Company the charges are without merit.

Auditors' Report

To the Shareholders of
The Quaker Oats Company:

We have examined the consolidated balance sheet of The Quaker Oats Company (a New Jersey corporation) and subsidiaries as of June 30, 1972, and June 30, 1973, and the related consolidated statements of income and reinvested earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of The Quaker Oats Company and subsidaries as of June 30, 1972, and June 30, 1973, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

Arthur Andersen & Co.

Chicago, Illinois
August 23, 1973

Ten-Year Financial Summary

Year Ended June 30 (B)	Thousands of Dollars 1973	1972	1971
Net sales	**$990,767**	$795,240	$701,862
Income before extraordinary item	**42,123**	35,614	31,107
Extraordinary (charge) credit	**—**	—	(5,886)
Net income	**42,123**	35,614	25,221
Dividends: preferred stock	**452**	484	490
common stock	**14,711**	13,006	12,636
Reinvested earnings	**$184,610**	$187,561	$165,437
Per common share: (A)			
Income before extraordinary item	**$ 2.04**	$ 1.78	$ 1.56
Extraordinary (charge) credit	**—**	—	(.30)
Net income	**$ 2.04**	$ 1.78	$ 1.26
Dividends declared	**$ .72**	$ .68	$ .67

(A) Adjusted for stock splits.

(B) Results for 1972 through 1968 are restated to reflect the July 20, 1972, merger with Needlecraft Corporation of America, recorded as a pooling of interests. Prior years have not been restated because effect is not material.

1970	1969	1968	1967	1966	1965	1964
$612,845	$562,277	$554,199	$555,133	$498,358	$461,288	$433,461
28,659	25,998	21,479	18,782	17,572	16,311	14,221
—	(1,092)	—	898	—	—	—
28,659	24,906	21,479	19,680	17,572	16,311	14,221
490	495	507	528	568	581	612
11,737	10,704	9,710	8,868	8,864	8,822	8,807
$153,342	$140,641	$130,778	$118,890	$108,606	$100,466	$ 93,558
$ 1.45	$ 1.33	$ 1.11	$ .97	$ .91	$ .84	$ .73
—	(.06)	—	.05	—	—	—
1.45	$ 1.27	$ 1.11	$ 1.02	$ .91	$ .84	$ .73
.63	$ .58	$ .53	$ .49	$ .49	$ .49	$ .49

Chief Executive Officer

Robert D. Stuart, Jr.
President

Corporate Staff Officers

Operations and Administration

John D'Arcy, Jr.
Senior Vice President

Thomas B. Bartel
Vice President—Personnel

Sam H. Flint
Vice President—Corporate Operations

Corporate Affairs

Robert N. Thurston
Senior Vice President

Jack T. Redwine
Vice President and General Counsel

William F. Debelak
Secretary

Louis J. Mallardi, Jr.
Assistant Secretary

Joann A. Pitcher
Assistant Secretary

Howard J. Thomas, Jr.
Assistant Secretary

Finance and Planning

W. Fenton Guinee
Senior Vice President

Robert A. Bowen
Vice President and Controller

Richard D. Denison
Vice President—Planning and Analysis

Peter B. Fritzsche
Vice President—Business Development

Richard D. Jaquith
Treasurer

Herbert E. Trenning
Assistant Treasurer

Group Management

Grocery Products

Kenneth Mason
Group Vice President

Henry T. Chandler
Vice President—Sales and Distribution

Samuel T. Gentles
Vice President—Packaging Services

Richard H. Glantz
Vice President and General Manager
Frozen Foods Division

Frank J. Morgan
Vice President
President—The Quaker Oats Company of Canada Limited

Robert O. Nesheim
Vice President—Research and Development

Royce S. Ramsland
Vice President—Purchasing Services

William D. Smithburg
Vice President and General Manager
Cereals and Mixes Division

Jack M. Young
Vice President—Marketing Services

International Grocery Products

Augustin S. Hart, Jr.
Group Vice President

Paul E. Price
Vice President and General Manager

Anthony J. Dimino
Vice President—Mexico

Ronald G. Lagden
Vice President—Europe

Toys and Recreational Products

Frank C. Schell, Jr.
Group Vice President

Henry H. Coords
Vice President
President—Fisher-Price Toys Division

Jack H. Asthalter
President—Marx Toys Division

Lowell Fixler
President—Needlecraft Division

Industrial and Institutional Products

Archibald McClure
Group Vice President

Frederick D. Montgomery
Vice President and General Manager
Restaurants Division

Alan R. Ryan
Vice President and General Manager
Burry Division

Leonard W. Steiger, Jr.
Vice President and General Manager
Chemicals Division

Directors

Silas S. Cathcart
Chairman and Chief Executive Officer
Illinois Tool Works, Inc.
Chicago, Illinois

***John D'Arcy, Jr.**
Senior Vice President
Operations and Administration

***W. Fenton Guinee**
Senior Vice President
Finance and Planning

Richard D. Harrison
President and Chief Executive Officer
Fleming Companies, Inc.
Oklahoma City, Oklahoma

***Augustin S. Hart, Jr.**
Group Vice President
International Grocery Products

Dr. Lawrence A. Kimpton
Formerly Chancellor
University of Chicago

***Kenneth Mason**
Group Vice President
Grocery Products

***Archibald McClure**
Group Vice President
Industrial and Institutional Products

Donald E. Meads
Executive Vice President and
Director, INA Corporation
Philadelphia, Pennsylvania

Mrs. G. G. Michelson
Senior Vice President
R. H. Macy and Company
New York, New York

Merrill E. Olsen
Formerly Vice President and
General Counsel

Dr. Walter J. Salmon
S. S. Kresge Professor of Marketing
Harvard Business School
Boston, Massachusetts

***Frank C. Schell, Jr.**
Group Vice President
Toys and Recreational Products

Gilbert H. Scribner, Jr.
President, Scribner & Co.
Chicago, Illinois

***Robert D. Stuart, Jr.**
President and Chief Executive Officer

***Robert N. Thurston**
Senior Vice President
Corporate Affairs

Arthur M. Wood
Chairman and Chief Executive Officer
Sears, Roebuck and Co.
Chicago, Illinois

*Members of the Executive Committee

Corporate Headquarters
Merchandise Mart Plaza
Chicago, Illinois 60654

U. S. Transfer Agents and Registrars
The First National Bank of Chicago
One First National Plaza
Chicago, Illinois 60670

The Chase Manhattan Bank
One Chase Manhattan Plaza
New York, New York 10015

Dividend Disbursing Agent
The First National Bank of Chicago

Canadian Transfer Agent
National Trust Company, Limited
21 King Street East, Toronto 1, Ontario

Canadian Registrar
Crown Trust Company
302 Bay Street, Toronto, Ontario

Auditors
Arthur Andersen & Co.
69 West Washington Street
Chicago, Illinois 60602

Shares Listed
New York Stock Exchange
Midwest Stock Exchange
Pacific Coast Stock Exchange
The Toronto Stock Exchange
The Stock Exchange, London
Amsterdam Stock Exchange

Ticker Symbol: OAT

Meet Some of Quaker's People

With Quaker Cereals

Rita Maher, administrative assistant, holding Cap'n Crunch; *Earl Carr,* shift foreman, holding Instant Quaker Oatmeal; *Ross Wilson,* plant superintendent, holding traditional Quaker Oats—from the Cedar Rapids, Iowa, plant, which last year celebrated its centennial.

With Fisher-Price Toys

Jean Eichler, injection molding press operator at the Holland, New York, plant, holding the Crib & Playpen Cuddly Cub and the traditional Snoopy Sniffer; *John Slack,* senior industrial engineer at the Medina, New York, plant, looking at the Fisher-Price Movie Viewer.

With Ken-L Ration Dog Food

Jack Korinke, kennelmaster at the Barrington, Illinois, kennels, holding a lively dachshund puppy and standing next to both regular and cheese-flavored varieties of Ken-L Ration Burger.

With Aunt Jemima and Celeste Frozen Foods

Albert Currie, maintenance apprentice at the Jackson, Tennessee, frozen foods plant, with Aunt Jemima Original and Blueberry Frozen Waffles; *Phyllis Lewis,* production and sanitation worker at the Rosemont, Illinois, Celeste plant, with new Pepperoni and De Luxe Pizzas.

With Quaker Products in Canada

Gilbert Howson, shipper, with Croque Nature de Quaker (Quaker Harvest Crunch) ready-to-eat cereal; *Karen Northfold,* laboratory technician, with Quaker Bran Muffin and Sugar Drop Cookie Mixes and Aunt Jemima Frozen Blueberry Waffles (Gaufres); *Ingo Trautman,* cat food sales representative, with four varieties of new Puss 'n Boots Flavour Morsels (Bouchés de Choix)—at the Peterborough, Ontario, plant.

With the Chemicals Division

Carl Fields, Jr., foreman at the Cedar Rapids chemicals plant, with a drum of QO Furfural.

With Marx Toys

Mahlon Hirsh, toy design engineer, with the 727 Marx Jet; *Richard Rastetter,* package designer, alongside the Marx Big Wheel and holding the Square Shooters and Baseball Bagatelle games—at the Erie, Pennsylvania, Marx plant.

With Quaker Products in the United Kingdom

Winston Haisley, foreman, with Felix Complete Cat Food, Chunky Minced Morsels for dogs, and canned Felix and Chunky pet food; *Arthur Smale,* puffing machine operator, with Quick Quaker Oats and Sugar Puffs ready-to-eat cereal—at the Southall, England, plant of Quaker Oats Limited.

With Magic Pan Restaurants

Margaret Elder and *Wilke Harrison,* who serve delicious crépe entrees and desserts at the Walton Street Magic Pan Créperie in Chicago.

With Burry Cookies and Crackers

Guillermo Cott, mechanic, with Euphrates and Milk Lunch crackers; *Eola Tiggit,* packer with Girl Scout Cookies (Chocolate and Vanilla Cremes); *Irmgard Michaels,* product development technician, with Amandel and Scooter Pie cookies—from the Elizabeth, New Jersey, Burry plant.

With La Azteca in Mexico

Francisco Nuñez Toro, night shift foreman, with Express powdered chocolate beverage and Presidente candy; *Josefina Figueroa Arteaga,* candy making machine operator, with Abuelita, Morelia Presidencial and Tres Coronas beverages and Carlos V candy—at the Mexico City La Azteca plant.

With Needlecraft Products

Mark Zimmerman, mill mechanic, with the Ripple Afghan Kit; *Veronica Cudahy,* machine operator, with the Americana calendar kit and Wintuk synthetic yarn—at the Grafton, Wisconsin, plant of Needlecraft Division.

Milk Lunch
CARLOS V

Felix
Quaker Oats Ltd
Quick
Quaker
Oats
Sugar Puffs
Sugar Puffs
63B
FREE INSERT!
Felix
Catfood
172
NEW
Felix
Catfood
MEATY CHUNKS
48 CANS
30
Quick
Quaker
Oats
BIG WHEEL